

FIRST NATIONAL

FINANCIAL INCOME FUND



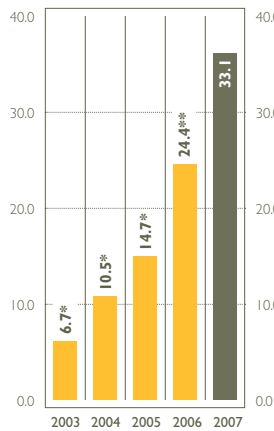
Our strengths are
based on a commitment
to service excellence,
technological
innovation and prudent
risk management.

ANNUAL REPORT 2007

PROFILE First National Financial Income Fund (TSX: FN.UN) owns a 19.97% interest in First National Financial LP, a Canadian-based originator, underwriter and servicer of predominantly prime residential (single-family and multi-unit) and commercial mortgages. With more than \$33 billion in mortgages under administration, First National is Canada's largest non-bank originator and underwriter of residential mortgages and is among the top three in market share in the growing mortgage broker distribution channel.

Our Performance at a Glance

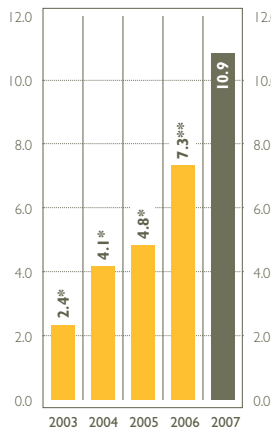
Mortgages Under Administration
(in \$ billions)



36%

Year-over-year growth
2006 to 2007

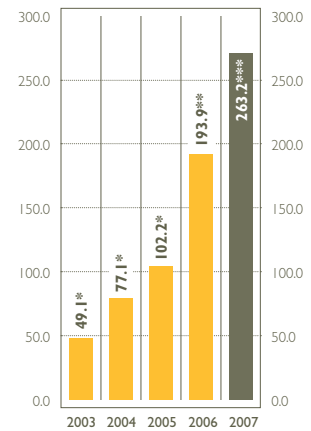
Mortgage Originations
(in \$ billions)



49%

Year-over-year growth
2006 to 2007

Revenue
(in \$ millions)



36%

Year-over-year growth
2006 to 2007

* 2003 to 2005 figures for period ended March 31, fiscal year-end for First National Financial Corporation, predecessor to First National Financial LP.
 ** 2006 figures reflect the operations of First National Financial Corporation from January 1, 2006 to June 14, 2006 combined with the operations of First National Financial LP from June 15, 2006 to December 31, 2006.
 *** Excluding fair value adjustments

Key Success Factors

1

Canada's largest non-bank mortgage lender

2

Leader in high-growth mortgage distribution channel

3

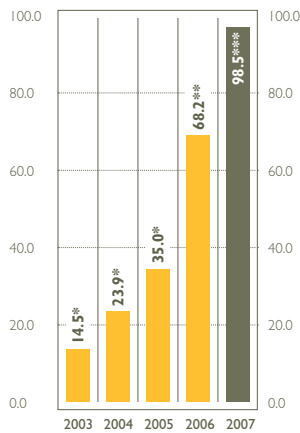
Diversified revenue and funding sources

4

Experienced management with 80% retained interest

Adjusted EBITDA

(in \$ millions)

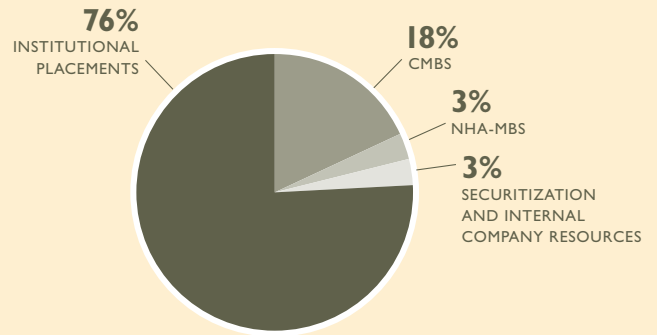


44%

Year-over-year growth 2006 to 2007

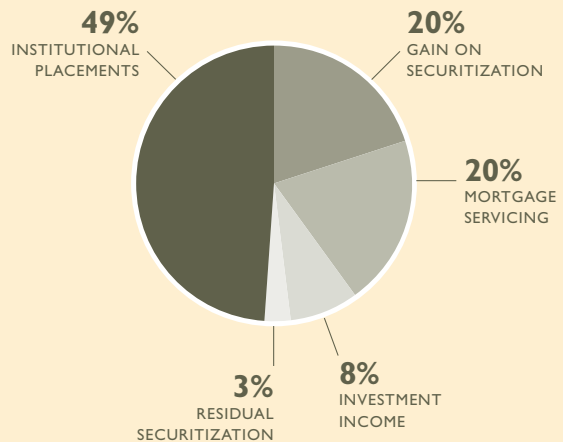
Funding Sources

(for the period ended December 31, 2007)



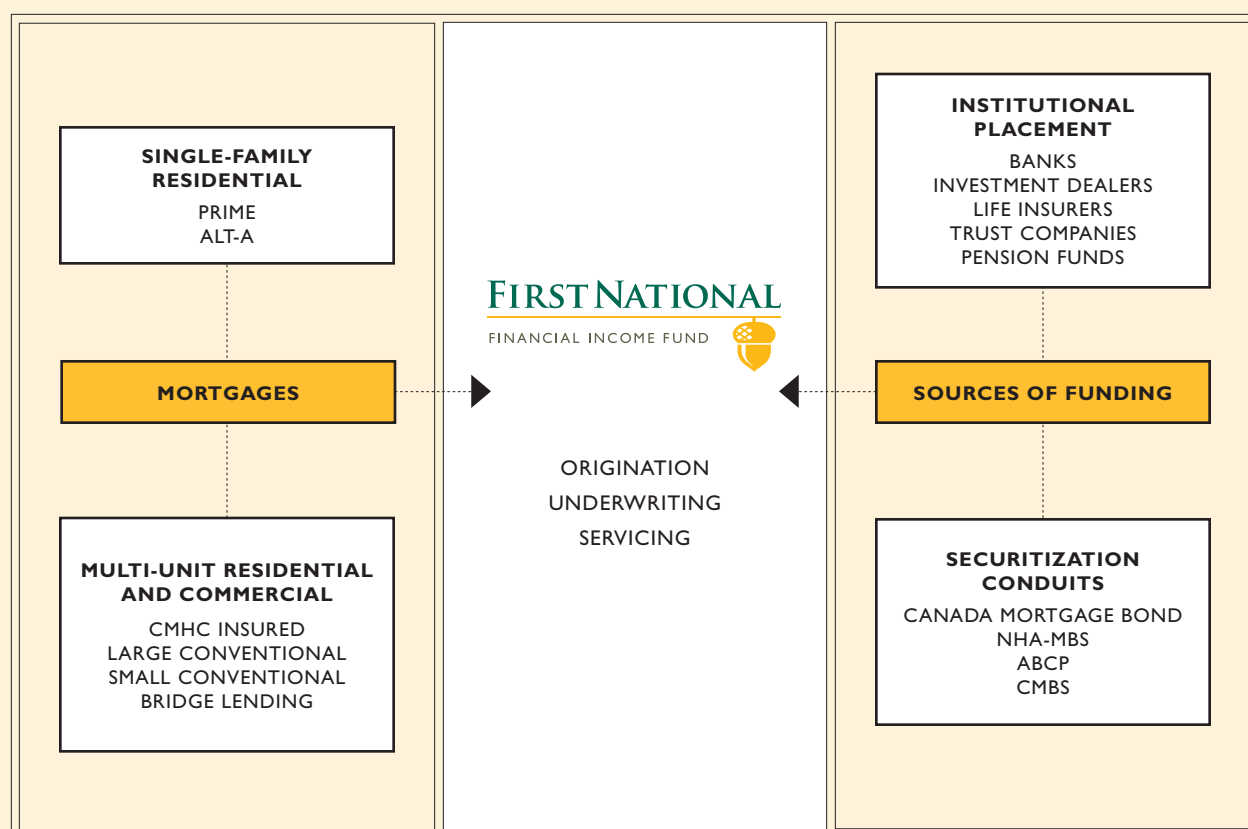
Revenue Sources

(for the period ended December 31, 2007)



First National’s business model is simple: we originate, underwrite and service mortgages.

Business Model

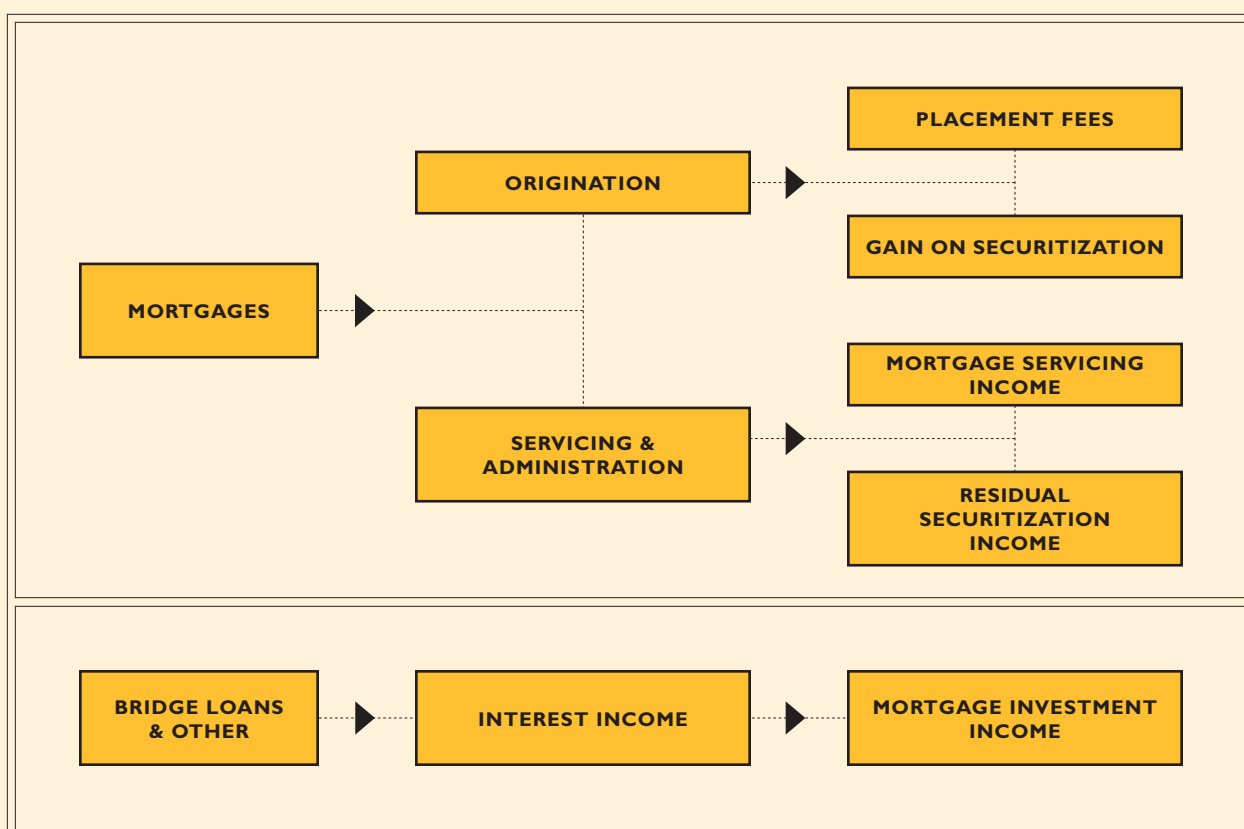


We offer a full range of mortgage products and an end-to-end service solution for both residential and commercial clients. Our single-family mortgages are originated through the residential mortgage broker channel, while our multi-unit and commercial mortgages are originated through an experienced team of in-house underwriters.

Our mortgages are funded through a diversified mix of both institutional placements and securitization conduits. This gives us flexibility to finance and manage our mortgages in a low risk and cost effective manner. We service virtually all of the mortgages we originate, which creates stable, consistent and predictable cash flows.

First National has three revenue sources: origination, servicing & administration and mortgage investment income.

Revenue Model



Mortgage originations generate revenues at the time they are placed with institutional investors or sold to securitization conduits. This revenue is recorded as either placement fees or gain on securitization. Additional revenue earned on our securitization conduits is recognized as residual securitization income over the term of the mortgage.

Recurring revenue is also earned from servicing our mortgage portfolio. Another important revenue source is mortgage investment income. This is derived from interest earned on securitization receivables and other mortgage-related assets, such as mortgage and loan investments, servicing rights and mortgages accumulated for sale.

Fellow Unitholders,
 First National's strong performance amid challenging liquidity conditions demonstrates the resilience of our business model and our team's commitment to excellence in service, technological innovation and prudent risk management.

First National's first full year as a publicly traded entity was characterized by record volume in originations and mortgages under administration as well as strong growth in both revenue and profitability. This notable performance was mainly attributable to favourable housing market conditions and our leading market share in the mortgage broker channel. I am extremely proud of how our team pulled together and persevered to realize these achievements in the face of difficult credit market conditions in the latter part of the year.

Prudent Measures

Unique challenges were posed for the entire financial services industry, including First National, due to the volatility of the asset-backed commercial paper (ABCP) market. At the time of the onset of the credit market volatility in August 2007, our ABCP-funded mortgages accounted for less than 10% of our total mortgages under administration. However, the effects of the credit tightening were significant, prompting us to take action to ensure prudent management of our risk exposure and proper valuation of our financial assets. The result was a decision to record a non-cash, fair value adjustment of \$22.9 million in the third quarter, which represents an estimate of the possible impact. It is important to note that this adjustment will be reversed in the future if market conditions improve and ABCP spreads narrow. In fact, the widening trend reversed significantly in January 2008. Management will continue to monitor

this trend and will reverse the adjustment should these tightened spreads stabilize.

We have been successful in implementing specific initiatives to deal with the ABCP volatility. These include:

- redirecting new originations to institutional investors instead of the ABCP market;
- effecting significant sales of mortgages financed by ABCP to institutional investors;
- increasing spreads on new commitments to compensate for increased funding costs; and
- refinancing all ABCP issued by First National's own sponsored conduit.

In just five months, from August to year-end, we reduced our exposure to ABCP by 30%. The speed and efficiency of this reduction demonstrates the quality and liquidity of these assets. I will also point out that First National's diverse funding strategy was instrumental in mitigating the effects of the credit market volatility.

Achievements

First National's key metrics for the year showed tremendous strength. Mortgages under administration surpassed the \$30-billion mark during the third quarter, finishing the year at \$33.1 billion. Also reaching a high water mark was mortgage origination volume, which reached a record \$10.9 billion in 2007, up almost 50% from the prior year. Excluding the effect of the year's non-cash, fair value adjustments, annual revenue totalled \$263 million, up 36%, while adjusted EBITDA was \$98.4 million, an increase of 44%. Strong performance throughout the year prompted us to increase monthly distributions by 31.5% in June and declare a special year-end distribution of \$0.06 per unit.

“Our diverse funding strategy was instrumental in mitigating the effects of the credit market volatility.”

Continued Growth in Market Share

These outstanding results were primarily driven by two key factors. The first was First National's growing market share in the single-family residential mortgage broker channel. Industry data from Filogix, one of Canada's leading providers of mortgage transaction data, reports that we are now number two in market share. The second factor was robust volume in commercial mortgage originations, driven by favourable market conditions.

Outlook

Our outlook continues to be optimistic. At the time of writing, ABCP funding spreads have narrowed significantly while mortgage spreads have widened. If there is no further deterioration in the credit markets, there will be no need for future downward fair value adjustments. In addition, management will continue to monitor the recent ABCP normalization trend and will reverse the adjustment should these tightened spreads stabilize.

Looking at the industry environment, we believe that the outlook remains favourable. The overall strength of the Canadian economy is sound, despite some evidence of regional moderation. The mortgage broker distribution channel shows signs of prolonged growth, as does First National's leadership position within it. We expect continuing growth in mortgages under administration in 2008, mainly driven by our own originations.

First National reaped the benefits of a strong commercial mortgage market in 2007; however, this is showing signs of slowing in 2008, primarily due to the credit tightening. Though this does pose challenges for First National, it has also created opportunities due to competitors withdrawing from the market. We feel that we are in a fortunate position to capitalize on these industry developments given the enduring strengths of our business model and our notable track record of successful execution.

Our formula for sustainable performance is based on four key priorities. The first is reducing funding costs by employing diverse and innovative funding sources. We recently achieved a milestone toward this goal by obtaining approval to be an issuer of NHA mortgage-backed securities and a seller to the Canada

Mortgage Bond program, selling over \$500 million of mortgages into this program in December. These developments provide further funding diversification and also help to reduce our overall funding costs.

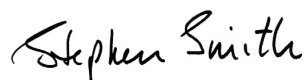
“...our unwavering commitment to excellent service has been the hallmark of our company since First National's founding almost 20 years ago.”

The second is increasing mortgages under administration by leveraging our growing leadership position with mortgage brokers. Regional expansion will also contribute to the realization of this goal. Our Montreal office has recently opened and we plan to strengthen our presence by bringing First National's expertise and values to the Quebec residential market. The third priority is maintaining our unwavering commitment to excellent service, which has been the hallmark of our company since First National's founding almost 20 years ago. Being mindful of the importance of improving efficiencies, our fourth priority is to continue reducing costs through the use of systems and technology.

We closed 2007 with several achievements behind us and look forward to continued success in 2008. I offer many thanks to our team for your dedication to excellent service. I thank our mortgage brokers and customers for your continued support and valuable feedback and acknowledge my fellow directors for your strategic counsel. To our unitholders, I extend gratitude on behalf of all of us at First National for putting your trust in us.

We look forward to delivering continued unitholder value in 2008 and beyond.

Yours truly,



Stephen Smith
Chairman and President

First National's Board and management team fully acknowledge the importance of its duty: to serve the long-term interests of unitholders.

We believe that sound corporate governance is essential for earning unitholder trust and confidence and for properly guiding the Fund towards ongoing success. As such, First National is committed to the highest standards of integrity to ensure transparent corporate governance, including timely disclosure and the nurturing of a culture of accountability and responsibility across the organization.

Policies

In addition to monitoring the Fund's strategic planning activities and assessing results relative to its goals and objectives, First National's Board has adopted several policies that reflect best practices in governance and disclosure. These include a Disclosure Policy, a Code of Business Conduct, a Whistleblower Policy and an Insider Trading Policy. The policies are substantially compliant with the corporate governance guidelines of the Canadian Securities Administrators. As a public company, the Board continues to update, develop and implement appropriate governance policies and practices as it sees fit.

Committees

The Board of Directors has created an Audit Committee and a Compensation, Governance and Nominating Committee to further the effective functioning of the Fund's corporate governance strategy.

The **Audit Committee's** responsibilities include:

- the oversight and supervision of the audit of the Fund's financial statements;
- the management of the relationship with the auditor of the Fund's financial statements;
- the oversight and supervision of the accounting and financial reporting practices and procedures of the Fund;
- the oversight and supervision of the adequacy of the Fund's internal accounting controls and procedures; and
- the oversight and supervision of the quality and integrity of the Fund's financial statements.

All of the Audit Committee members are independent directors and have been deemed financially literate for the purposes of the Canadian Securities Administrators' Multilateral Instrument 52-110 – Audit Committees.

Committee Members:

John Brough (Chair), Duncan Jackman and Robert Mitchell

The **Compensation, Governance and Nominating Committee's** responsibilities include:

- annually reviewing the President's goals and objectives for the coming year and providing an appraisal of the President's performance;
- making recommendations concerning compensation of the Fund's senior executive officers and remuneration of the Board of Directors;
- developing the Fund's approach to corporate governance issues and compliance with applicable laws, regulations, rules, policies and orders with respect to such issues;
- advising the Board of Directors on filling director vacancies;
- periodically reviewing the composition and effectiveness of the directors and the contributions of individual directors; and
- adopting and periodically reviewing and updating the Fund's written disclosure policy.

All of the Compensation, Governance and Nominating Committee members are independent directors for the purposes of the Canadian Securities Administrators' Multilateral Instrument 58-101 – Disclosure of Corporate Governance Practices.

Committee Members:

Stanley Beck (Chair), Robert Courteau and John Harris

The Board of Directors consists of eight members – six of whom are independent. Collectively, the Board has extensive experience in mortgage lending, real estate, strategic planning, law and finance.

Stephen Smith, *Chairman*, is President and co-founder of First National Financial Corporation. Mr. Smith has been an innovator in the development and utilization of various securitization techniques to finance mortgage assets. He is a member of the Association of Professional Engineers of Ontario and is also Vice Chairman of GO Transit. He has a Master of Science from the London School of Economics and Political Science and an Honours Bachelor of Science from Queen's University.

Moray Tawse is Vice President, Mortgage Investments and co-founder of First National Financial Corporation. In addition to directing the operations of all commercial mortgage origination activities for the company, Mr. Tawse is one of Canada's leading experts on commercial real estate and is often called upon to deliver keynote addresses at national real estate symposiums. Prior to co-founding First National, Mr. Tawse was Manager of Mortgages for the Guaranty Trust Company of Canada from 1983 to 1988.

Stanley Beck, Q.C., is President of Granville Arbitrations Limited. He was previously a Professor of Law and Dean at Osgoode Hall Law School. From 1985 to 1990, Mr. Beck served as Chairman of the Ontario Securities Commission. He is also Chairman of 407 International Inc.

and GMP Capital Trust and serves as a director of Scotia Utility Corp., Scotia NewGrowth Corp and Hollinger Inc.

John Brough recently retired from his position as President of both Wittington Properties Limited and Torwest, Inc., a position he held from 1998 to 2007. From 1996 to 1998, he was Executive Vice President and Chief Financial Officer of iStar Internet, Inc. From 1974 to 1996, he was with Markborough Properties, Inc., where he served as Senior Vice President and Chief Financial Officer. Mr. Brough is a director of Kinross Gold Corporation, Silver Wheaton Corp., Livingston International Inc. and Quadra Mining Ltd.

Robert Courteau is President and Managing Director of SAP Canada and is responsible for all of SAP's business activities in Canada. Prior to joining SAP Canada in January 2004, Mr. Courteau served as the Executive Vice President responsible for Canadian sales and consulting services at EDS Corporation. Mr. Courteau has a Bachelor of Commerce from Concordia University.

John Harris is the Chief Executive Officer of Harris Steel Inc., a wholly-owned subsidiary of Nucor Corporation. Previously, Mr. Harris served as Chairman of Harris Steel Inc. Mr. Harris has a Bachelor of Arts

from Trent University and a Master of Business Administration from the University of Toronto.

Duncan Jackman is Chairman, President and Chief Executive Officer of E-L Financial Corporation Limited, and Chairman and President of Economic Investment Trust Limited and United Corporations Limited. Prior to this, he was a portfolio manager at Cassels Blaikie and an investment analyst at RBC Dominion Securities Inc. Mr. Jackman has a Bachelor of Arts in Literature from McGill University.

Robert Mitchell has been President of Dixon Mitchell Investment Counsel Inc., since 2000. Prior to that, he was Vice President, Investments at Seaboard Life Insurance Company. Mr. Mitchell is a director and chairs the audit committee of Discovery Parks Holdings Ltd., trustee for Discovery Parks Trust. Mr. Mitchell has a Master of Business Administration from the University of Western Ontario, a Bachelor of Commerce (Finance) from the University of Calgary and is a CFA charterholder.

Management's Discussion and Analysis

The following management's discussion and analysis of financial condition and results of operations is prepared as of March 4, 2008. This discussion should be read in conjunction with the audited consolidated financial statements of First National Financial Income Fund (the "Fund") and First National Financial LP ("FNFLP") as at and for the year (the "period") ended December 31, 2007 (as applicable) and the notes thereto. This discussion should also be read in conjunction with the audited consolidated financial statements and notes thereto of the Fund and FNFLP for the nine months ended December 31, 2006. The audited consolidated financial statements of the Fund and FNFLP have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

The Fund earns income from its 19.97% interest in FNFLP. The Fund accounts for its investment in FNFLP using the equity method and therefore does not consolidate the results of operations of FNFLP. As a result, financial statements with accompanying notes thereon have been presented for both the Fund and FNFLP. In addition, the following management's discussion and analysis ("MD&A") presents a discussion of the financial condition and results of operations for both the Fund and FNFLP.

Information for the comparative period ended December 31, 2006 reflects the operations of First National Financial Corporation (as predecessor to FNFLP – "FNFC") from January 1, 2006 to June 14, 2006 combined with the operations of FNFLP from June 15, 2006 to December 31, 2006.

This MD&A contains forward-looking statements. Please see "Forward-Looking Statements" for a discussion of the risks, uncertainties and assumptions relating to these statements. The selected financial information and discussion below also refer to certain measures to assist in assessing financial performance. These "non-GAAP measures" such as "EBITDA", "Adjusted Net Income", "Distributable Cash", and "Distributable Cash per Unit" should not be construed as alternatives to net income or loss or other comparable measures determined in accordance with GAAP as an indicator of performance or as a measure of liquidity and cash flow. Non-GAAP measures do not have standard meanings prescribed by GAAP and therefore may not be comparable to similar measures presented by other issuers.

The Fund is entirely dependent upon the operations and financial condition of FNFLP. The earnings and cash flows of FNFLP are affected by certain risks. For a description of those risks, please refer to the "Risk and Uncertainties Affecting the Business" section.

Unless otherwise noted, tabular amounts are in thousands of Canadian dollars.

Additional information relating to the Fund and FNFLP is available in the Fund's profile on the System for Electronic Data Analysis and Retrieval ("SEDAR") website at www.sedar.com.

GENERAL DESCRIPTION OF THE FUND AND FIRST NATIONAL FINANCIAL LP

Pursuant to an underwriting agreement dated June 6, 2006 and initial public offering ("IPO"), the Fund sold 10,600,000 units of the Fund ("Fund Units", "Units", or "Unit"), at a price of \$10.00 per Unit for proceeds totalling \$106,000,000. The proceeds of the offering were used to partially fund the indirect acquisition (through the Fund's wholly-owned subsidiary, First National Financial Operating Trust) by the Fund of a 17.94% interest in First National Financial LP ("FNFLP"). The underwriters were also granted an over-allotment option to purchase 1,200,000 Units at \$10.00 per Unit. The option was exercised in full on July 11, 2006. Accordingly, the Fund indirectly holds a 19.97% interest in FNFLP and FNFC holds an 80.03% controlling interest in FNFLP. Concurrent with the initial public offering and as part of the acquisition agreement between FNFLP and FNFC on June 15, 2006, FNFLP purchased all of FNFC's assets and assumed its liabilities, except for future income tax liabilities, which are payable by FNFC.

First National Financial Income Fund

The Fund is an unincorporated, open-ended trust established under the laws of the Province of Ontario on April 19, 2006, pursuant to a Declaration of Trust. The Fund was established to acquire and hold, through a newly constituted wholly-owned trust, First National Financial Operating Trust (the "Trust"), investments in the outstanding limited partnership units of FNFLP. Each unitholder participates pro rata in any distribution from the Fund. Income tax obligations related to the distributions of the Fund are the obligations of the unitholders.

The Fund effectively commenced operations through its indirect investment in FNFLP on June 15, 2006, and the income reported by the Fund commenced on that date.

SELECTED QUARTERLY INFORMATION**Quarterly Results of First National Financial Income Fund**

(in \$000s, except per unit amounts)

	Revenue	Net Income (Loss) for the Period	Net Income (Loss) per Unit	Total Assets
2007				
Fourth Quarter	\$ 2,803	\$ 3,297	\$ 0.28	\$ 103,689
Third Quarter	\$ (980)	\$ (986)	\$ (0.08)	\$ 104,574
Second Quarter	\$ 2,698	\$ (5,508)	\$ (0.47)	\$ 109,241
First Quarter	\$ 2,026	\$ 2,020	\$ 0.17	\$ 109,641
2006				
Fourth Quarter	\$ 1,602	\$ 1,596	\$ 0.14	\$ 110,417
Third Quarter	\$ 1,825	\$ 1,819	\$ 0.16	\$ 111,617
Second Quarter	\$ 488	\$ 487	\$ 0.05	\$ 100,128

INVESTMENTS

At December 31, 2007, the Fund had an investment in 11,800,000 units (19.97%) of First National Financial LP at a cost of \$111,640,000. Under Canadian GAAP, the Fund is required to account for this investment using the equity method. During the year ended December 31, 2007, the Fund's earnings from FNFLP were \$14.5 million, amortization of identifiable assets inherent in the investment was \$8.0 million and the carrying value of this investment at December 31, 2007 was \$101.8 million.

STATEMENT OF DISTRIBUTABLE CASH

(in \$000s, except where noted)

	For the quarter ended December 31 2007	For the year ended December 31 2007
First National Financial LP		
Distributable Cash from First National Financial LP	\$ 14,873	\$ 74,373
First National Financial Income Fund		
Weighted Average Share of Distributable Cash from First National Financial LP	2,970	14,853
Trust Administration Expenses	6	24
Distributable Cash from First National Financial Income Fund ⁽¹⁾	2,964	14,829
Distributable Cash per Unit (\$/Unit) ⁽¹⁾	0.25	1.26
Distributions Declared	4,396	14,278
Distributions Declared per Unit (\$/Unit)	\$ 0.37	\$ 1.21
Payout ratio	148%	96%

(1) Distributable cash and distributable cash per unit are non-GAAP measures generally used by Canadian open-ended trusts as an indicator of financial performance. They are considered key measures as they demonstrate the cash available for distributions to unit holders.

EXPENSES

Trust administration expenses include trustees' fees and travel costs.

DISTRIBUTIONS

The initial public offering described above closed on June 15, 2006. The Fund made its first distribution of \$0.11875 per unit, representing a monthly distribution of \$0.07917 per unit plus the stub period of June 15, 2006 to June 30, 2006, on August 15, 2006. Beginning on September 15, 2006, the Fund made monthly distributions of \$0.07917 per unit on or around the 15th of each month. As declared on May 17, 2007, the Fund increased the monthly distribution to \$0.10417 per unit beginning with the May 2007 distribution. Distributions at this rate were paid beginning on June 15, 2007 and have continued monthly with the latest distribution being paid on February 15, 2008. The Fund also announced a special distribution on December 14, 2007 payable on March 17, 2008 which was determined to be for \$0.06 per unit. For the year, these distributions of approximately \$14.3 million were equivalent to the distributions that the Fund received from FNFLP. This monthly distribution rate represents an annualized distribution rate of \$1.25 per unit, a 31.5% increase from the distributions contemplated at the time of the IPO. The following table calculates the payout ratio based on the Fund's pro rata share of distributable cash earned by FNFLP. Note that the amount of distributable cash from FNFLP has been determined using guidance issued by the Canadian Securities Administrators in National Policy 41-201. Please refer to the "Key Performance Indicators" section of the MD&A for a discussion of this change.

INCOMETAXES

The Fund is a mutual fund trust for income tax purposes. As such, the Fund is only taxed on any amount not allocated to unitholders. The Fund intends to distribute substantially all of its taxable income to its unitholders and also intends to comply with the provisions of the Income Tax Act (Canada) that permit, among other items, the deduction of distributions to unitholders from the Fund's taxable income.

As described in the Fund's financial statements and the "Income Tax Matters" section later in this analysis, on June 12, 2007 the government enacted previously announced legislation to impose additional income taxes on the Fund commencing on January 1, 2011. Accordingly, the Fund's financial statements have been affected in two ways: (1) a future tax liability has been accrued based upon the net book value of the intangible assets inherent in the carrying value of the Fund's investment in FNFLP; and (2) a future tax asset has been accrued related to differences between the net book value of assets and liabilities in FNFLP and their tax cost base.

ACCRUED FUTURE TAX LIABILITY

The first issue relates to the intangible assets described in Note 2 to the financial statements. Because there is a difference between the accounting carrying value of these assets and their underlying tax carrying value, GAAP requires that a future tax liability be accrued. This was effectively accrued at the time of the IPO based on the current tax rate for income trusts, which then was a rate of Nil%. With new rates being enacted on June 12, 2007, the effective tax rate for the Fund as at January 1, 2011 was changed to approximately 31.5%. Based on this new rate, the Company accrued a future tax liability of \$9.0 million in the second quarter of 2007. In December 2007, the federal government announced general reductions to corporate taxes in 2011 and 2012 that have reduced the Fund's liability described above by \$800,000 to \$8.2 million. Beginning in January 1, 2011, this liability is expected to be drawn down as the Company continues to amortize the related intangible assets until 2016. This future tax charge is an accounting convention and has no effect on the distributable cash of the Fund.

ACCRUED FUTURE TAX ASSET

Similar to the discussion above, there are also differences in accounting and tax carrying values of certain assets and liabilities in FNFLP. Because there is no tax levied at the partnership level, these differences are temporary and require tax allocation accounting at the Fund level. In quarters ended prior to June 12, 2007, these differences had been accounted for using a tax rate of Nil. Now that new rates have been enacted, the Fund has accounted for these differences with higher tax rates and accrued a \$500,000 future tax asset. The tax asset is the Fund's estimated pro rata share of tax benefits that FNFLP will realize in the periods subsequent to December 31, 2010 and is based on timing differences related to the period June 15, 2006 (the IPO date) to December 31, 2007. Up until June 12, 2007, the Fund had

been applying tax rates to temporary differences in FNFLP at a Nil tax rate. This was based on the assumption that the Fund would make sufficient tax deductible cash distributions to unitholders such that the Fund's taxable income would be Nil for the foreseeable future. The new legislation enacted on June 12, 2007 limits the tax deductibility of cash distributions such that income taxes may become payable in the future. The future tax asset also incorporates the federal tax rate changes as described above.

The Fund has estimated both of these future income tax accruals based on its best estimates of the results of operations, current tax legislation and future cash distributions, assuming no material change to the Fund's current organizational structure. The Fund's estimate of future income taxes will vary as the Fund's assumptions vary in accordance with the factors above, and such variations may be material. Until 2011, the new legislation does not directly affect the Fund's distributable cash and as such, does not affect the Fund's financial condition.

OUTSTANDING SECURITIES OF THE FUND

At December 31, 2007 and at March 4, 2008, the Fund had 11,800,000 units outstanding.

First National Financial Corporation holds 47,286,316 exchangeable Class B LP units of FNFLP, each of which is exchangeable into one Fund Unit at no cost at any time at the option of First National Financial Corporation, and each of which carries a Special Voting Right that entitles the holder to receive notice of, attend and vote at all meetings of unitholders of the Fund.

CRITICAL ACCOUNTING ESTIMATES

Management makes estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements, and revenues and expenses during the reporting period. Management reviews these estimates on an ongoing basis, including those related to securitization accounting and future income taxes. Changes in facts and circumstances may result in revised estimates and actual results may differ from these estimates.

BUSINESS RISKS

The Fund is entirely dependent upon the operations and financial condition of FNFLP. The earnings and cash flows of FNFLP are affected by certain risks. For a description of those risks, please refer to the "Risk and Uncertainties Affecting the Business" section in the First National Financial LP portion of this analysis.

GUARANTEE

The Fund's wholly-owned subsidiary, First National Financial Operating Trust, has provided guarantees to and subordinated their rights to receive payments from FNFLP in respect of FNFLP's \$300 million bank credit facility.

First National Financial LP

BASIS OF PRESENTATION

The financial statements of First National Financial LP ("FNFLP" or the "Company") are prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). FNFLP is considered to be a continuation of FNFC's business following the continuity of interest method of accounting. Under this method of accounting, FNFLP's acquisition of the FNFC business is recorded at the net book value of FNFC's business assets and liabilities on June 14, 2006 and the equity of FNFLP represents the equity of the FNFC business at that date. The statements of income and cash flows for the year ended December 31, 2007 reflect the activities of FNFLP for the current fiscal year. Two sets of comparative figures for earnings and cash flows are disclosed. Those for the nine months ended December 31, 2006 are the audited results from the then fiscal year end of the Company (March 31, 2006). The unaudited figures for the year ended December 31, 2006 are presented as management believes the figures are more useful for comparison to the figures presented for the year ended December 31, 2007. The comparative figures for the nine months and year ended December 31, 2006 represent the activities of FNFLP from June 15 to December 31, 2006 combined with the historic activities of the FNFC business from the beginning of the period to June 14, 2006.

EXECUTIVE SUMMARY

The Company experienced a year of volatility. The first six months of 2007 featured strong growth in originations, mortgage under administration, revenue and Adjusted EBITDA. Although originations and mortgages under administration continued to show strong growth in the second half of the year, this was offset by a sudden change in credit markets in August 2007 which adversely affected the Company's results for the final six months of the year. The ensuing effect on the asset-backed commercial paper (ABCP) market prompted the Company to record a large fair value adjustment to its securitization receivable to reflect increased funding costs related to ABCP. Despite the severe consequences of these markets, the Company remained profitable and generated sufficient earnings to allow for the declaration of a one-time special distribution in December 2007.

RESULTS SUMMARY

- Abnormal market conditions in the ABCP market increased the cost of funding for a large portion of the Company's securitization activities such that the Company recorded a downward fair value adjustment of \$22.9 million in the third quarter to its securitization-related assets;
- Mortgages under administration grew to \$33.1 billion at December 31, 2007 from \$31.2 billion at September 30, 2007, an annualized increase of 24%; the growth from December 31, 2006, when mortgages under administration were \$24.4 billion, was 36%;
- Revenue, excluding the effect of all fair value adjustments, for the year ended December 31, 2007 grew by 36% year-over-year, mainly due to higher placement fees resulting from higher origination volumes;

- Adjusted EBITDA, excluding the effects of all fair value adjustments, increased by 44% for the year ended December 31, 2007 in comparison to the same period in the prior year. This increase has resulted from higher volumes experienced in many aspects of the company's business including placement fees on higher origination volumes; and
- For the fourth quarter, mortgage originations grew to \$2.8 billion from \$1.7 billion, a rate of annualized growth of 65%; and Adjusted EBITDA increased to \$24.4 million from \$18.3, a year-over-year increase of 33%.

SELECTED QUARTERLY INFORMATION FOR RESULTS OF FNFLP

(in \$000s, except per unit amounts)

	Revenue	Net Income for the Period	Net Income (\$/Unit)	Total Assets
2007				
Fourth Quarter	\$ 68,272	\$ 24,050	\$ 0.40	\$ 460,336
Third Quarter	\$ 54,518	\$ 5,110	\$ 0.09	\$ 692,737
Second Quarter	\$ 62,631	\$ 23,524	\$ 0.40	\$ 522,301
First Quarter	\$ 53,550	\$ 20,160	\$ 0.34	\$ 576,282
2006				
Fourth Quarter	\$ 49,551	\$ 18,038	\$ 0.30	\$ 528,116
Third Quarter	\$ 62,679	\$ 19,388	\$ 0.33	\$ 450,244
Second Quarter ⁽¹⁾	\$ 44,197	\$ 9,988	\$ 0.17	\$ 463,079

(1) Second quarter 2006 figures combine the results of FNFLP with its predecessor, FNFC, for the quarter.

First National's quarterly revenue can be divided into two categories, (1) seasonally affected revenues and (2) those which are steadily earned throughout its fiscal year. Mortgage servicing income, mortgage investment income interest, and, generally, residual securitization income accrue to the Company each quarter and will reflect the trend of the changing portfolio of mortgages under administration. Alternatively, origination (including placement and securitization) activities are more seasonal in nature. This is particularly true for single-family residential origination for which volumes follow the purchasing patterns of single-family home buyers; origination activity is generally slower in the first quarter of each year, increases in the second quarter, peaks in the third quarter and gradually retreats the last quarter of the year towards first quarter levels. Single-family origination has the effect of "smoothing out" net income fluctuations because the large amounts of revenue generated from single-family origination generally does not result in significant income due to the high percentage of related brokerage fees.

Both the seasonal and income smoothing trends are apparent in the information presented above. The one aberration is the third quarter which includes a charge for \$22.9 million related to the fair value adjustment of the Company's securitization assets. If this adjustment is added back, revenue for this quarter would have been \$77.4 million and in line with seasonal expectations.

SELECTED ANNUAL FINANCIAL INFORMATION FOR THE COMPANY'S FISCAL YEAR ENDS

(in \$'000s, except per unit amounts)

	December 31 2007	December 31 2006 ⁽¹⁾	March 31 2006
For the Period			
Income Statement Highlights			
Revenue	\$ 238,971	\$ 156,427	\$ 144,643
Brokerage fees	(102,886)	(67,891)	(47,915)
Other operating expenses	(61,999)	(37,007)	(37,796)
EBITDA ⁽²⁾	74,086	51,529	58,932
Amortization of capital assets	(1,242)	(803)	(895)
Interest paid to shareholders	–	–	(1,711)
Provision for income taxes	–	(3,312)	(19,994)
Net income	72,844	47,414	36,332
Distributions declared	71,497	30,406	–
Per Unit Highlights			
Net income per unit ⁽³⁾	\$ 1.23	\$ 0.80	\$ 0.61
Distributions declared per unit	\$ 1.21	\$ 0.51	N/A
At Period End			
Balance Sheet Highlights			
Total assets	460,336	528,116	279,751
Total long-term financial liabilities	\$ –	\$ –	\$ –

	December 31 2007	December 31 2006 ⁽¹⁾	March 31 2006
Reconciliation of EBITDA to Adjusted EBITDA			
EBITDA ⁽²⁾	\$ 74,086	\$ 51,529	\$ 58,932
Historic management compensation expenses ⁽⁴⁾	–	917	700
Revised management compensation ⁽⁵⁾	–	(1,125)	(1,500)
Adjusted EBITDA ⁽²⁾	\$ 74,086	\$ 51,321	\$ 58,132

(1) December 31, 2006 figures are for the nine-month period ended December 31, 2006.

(2) EBITDA and Adjusted EBITDA are not recognized earnings measures under GAAP and do not have standardized meanings prescribed by GAAP. Therefore, EBITDA and Adjusted EBITDA may not be comparable to similar measures presented by other issuers. Investors are cautioned that EBITDA should not be construed as an alternative to net income or loss determined in accordance with GAAP as indicators of the Company's performance or as an alternative to cash flows from operating, investing and financing activities as a measure of liquidity and cash flows.

(3) So that these measures are comparable among the indicated periods, per unit amounts have been calculated as if the Company converted to a partnership on April 1, 2004 and issued 59,086,316 partnership units. Prior to June 15, 2006, the Company had two shares outstanding.

(4) Management compensation for each of the two senior management executives while FNFC operated as a private company.

(5) Normalized compensation for each of the two senior management executives consistent with compensation policies that have been implemented on closing of the IPO.

VISION AND STRATEGY

The Company provides mortgage financing solutions to virtually the entire mortgage market in Canada. By offering a full range of mortgage products, a focus on customer service and superior technology, the Company views itself as one of the leading non-bank mortgage lenders in the industry. Growth has been achieved while maintaining a relatively conservative risk profile. The Company intends to continue leveraging these strengths to lead the non-bank mortgage lending industry in Canada, while appropriately managing risk.

The Company's strategy is built on four cornerstones: providing a full range of mortgage solutions; growing assets under administration; employing leading-edge technology to lower costs and rationalize business processes; and maintaining a conservative risk profile. An important consequence of the Company's strategy is its direct relationship with the mortgage borrower. Although the Company places most of its originations with third parties, FNFLP is perceived by all of its borrowers as the mortgage lender. This is a critical distinction. It allows the Company to communicate with each borrower directly throughout the term of the related mortgage. Through this relationship, the Company can negotiate new transactions and pursue marketing initiatives. Management believes this strategy will provide long-term profitability and sustainable brand recognition for the Company.

KEY PERFORMANCE DRIVERS

The Company's success is driven by the following factors:

- Growth in the portfolio of mortgages under administration;
- Growth in the origination of higher margin mortgages;
- Lowering the costs of operations through the innovation of systems and technology; and
- Employing innovative securitization transactions to minimize funding costs.

IMPACT OF TEMPORARY LOSS OF LIQUIDITY IN THE ASSET-BACKED COMMERCIAL PAPER ("ABCP") MARKET

The most significant development during the year was the deterioration of the ABCP market in Canada. On August 13, 2007, a non-bank sponsored ABCP issuer announced that it was having difficulty rolling over its maturing commercial paper ("CP") due to market concerns about liquidity and the quality of the underlying collateral. When the issuer's liquidity back stop supplier did not provide the requested liquidity support due to an interpretation of the underlying agreements, other investors in ABCP became concerned about liquidity in the entire ABCP market (including bank-sponsored ABCP). Accordingly, bids for ABCP diminished as CP investors invested elsewhere. This mismatch of supply and demand pushed pricing up such that high quality (AAA) ABCP that historically traded at a very small premium to bankers' acceptances ("BAs") began trading at 0.40 percentage points above BAs. In mid-September 2007, this trend was exacerbated as more buyers shied away from ABCP investment and spreads moved up to 0.50 percentage points in excess of BAs. Perhaps due to the increased liquidity demonstrated by the bank-sponsored ABCP issuers, these spreads subsequently

tightened such that at the date of this MD&A, bank-sponsored AAA ABCP is trading at approximately 0.10 percentage points in excess of BAs. While the Company does not have any direct exposure/investments in non-bank ABCP, the cost of bank-sponsored ABCP affects the Company's cost of funding for some securitization vehicles.

The Company is required to mark to market its securitization receivables at the end of each reporting period. A large portion of those receivables are calculated using assumptions about the cost of funding arranged through the ABCP market. At the time of reporting the results for the third quarter, the Company had approximately \$2.6 billion of mortgages under administration funded with ABCP, including all of its Alt-A products. Although the Company's exposure to ABCP at December 31, 2007 has been reduced to \$2.0 billion, the temporary increase in the cost of ABCP has adversely affected the Company in a number of ways: (1) third and fourth quarter cash flows from ABCP securitization vehicles were lower than expected; (2) the amount of future cash flows expected from ABCP conduits has become much more uncertain, affecting the fair value of current securitization receivable assets; and (3) the issuance of ABCP by First National Mortgage Trust (the Company's non-bank-sponsored ABCP conduit), though consisting mainly of prime insured mortgages, became challenging. The consequences of each of these issues will be addressed later in this MD&A.

Similar issues have also affected overall credit spreads in the market. The global consequences of the American sub prime mortgage collapse, among other factors, has drained liquidity from the capital markets. Together with growing fears on the value of some of the collateral underlying various financial assets, liquidity became scarce and credit spreads widened significantly. The implications to the Company of this change in the credit environment are also described throughout this MD&A.

GROWTH IN PORTFOLIO OF MORTGAGES UNDER ADMINISTRATION

Management considers the growth in mortgages under administration ("MUA") to be a key element of the Company's performance. The portfolio grows in two ways: through mortgages originated by the Company and mortgage servicing portfolios purchased from third parties. Mortgage originations not only drive placement fee and gain on securitization revenues, but perhaps more importantly, longer term values such as servicing fees, mortgage administration fees, renewal opportunities and a customer base for marketing initiatives. As at December 31, 2007, mortgages under administration grew to \$33.1 billion from \$24.4 billion as at December 31, 2006, an annualized rate of increase of 36%. During the current quarter, mortgages under administration grew to \$33.1 billion from \$31.2 billion as at September 30, 2007, representing a quarter-over-quarter increase of 6% and an annualized increase of 24%. Recently MUA growth has relied almost entirely on origination volumes as the market for commercial mortgage backed securities ("CMBS") securitizations has slowed significantly in Canada and there have been few servicing portfolios tendered. For the year ended December 31, 2007, non-originated servicing business increased MUA by almost \$2.2 billion. For the fourth quarter non-originated volumes totalled \$148 million.

GROWTH IN ORIGINATION OF HIGHER MARGIN MORTGAGES

The Company's main focus is on the prime single-family mortgage market. Prior to the credit issues currently affecting the market, these mortgages had tight spreads such that the Company's strategy was to sell these mortgages on commitment to institutional investors and retain the servicing. To augment this servicing income, the Company implemented strategies to increase volumes in higher margin markets such as the Alt-A and CMBS markets. Alt-A describes single-family residential mortgages that are originated using broader underwriting criteria than those applied in originating prime mortgages. Alt-A borrowers are generally considered "A" quality borrowers in terms of their credit histories, but do not qualify for a prime mortgage because of non-conformities, such as the extent of income disclosure and verification required. These markets are relatively more profitable than conventional mortgage lending markets and add to economies of scale in the Company's operations by further increasing mortgages under administration. A portion of Alt-A mortgages also qualify for mortgage insurance offered by Canadian mortgage insurers.

This strategy has altered with the change in the credit environment. While credit concerns have curtailed the issuance of CMBS indefinitely in Canada, spreads on prime single-family mortgages relative to government of Canada bond yields have increased significantly. In the spring of 2007, such spreads for discounted five-year mortgage rates were approximately 1.25%. At the end of December 2007, comparable spreads increased to more than 2% and as high as 2.5% subsequent to year end. As a consequence, regular prime single-family mortgages became "high margin" mortgages, such that the Company earned much higher gains on securitization on its primary mortgage product. While the Company has been successful in increasing volume for its Alt-A product, tighter underwriting criteria, rising mortgage rates and competition from mortgage insurance companies have slowed this growth down. For the year ended December 31, 2007, the Company originated \$721 million of Alt-A mortgages. This volume contrasts with the twelve-month period ended December 31, 2006 when the Company originated \$466 million of Alt-A mortgages. At December 31, 2007, the Company's securitized Alt-A mortgages under administration totaled \$921 million. As a result of the higher funding costs for ABCP described above, the Company raised its mortgage rate offerings on this product beginning in August 2007.

LOWERING COSTS OF OPERATIONS THROUGH INNOVATION OF SYSTEMS AND TECHNOLOGY

The Company has always used technology to provide for efficient and effective operations. This is particularly true for its MERLIN underwriting system, Canada's only web-based real-time broker information system. By creating a paperless, 24/7 available commitment management platform for mortgage brokers, the Company has reached a place among the top three ranked lenders in market share in the broker channel. This has translated into increased single-family origination

volumes and higher closing ratios (the percentage of mortgage commitments the Company issues that actually become closed mortgages). For the year ended December 31, 2007, single-family origination volumes were \$8.4 billion, compared to \$5.5 billion for the comparative period ended December 31, 2006.

APPROVAL AS BOTH AN ISSUER OF NHA-MBS AND SELLER TO THE CANADA MORTGAGE BOND PROGRAM

The Company has been involved in the issuance of National Housing Act – Mortgage Backed Securities ("NHA-MBS") since 1995, primarily through an agreement with the Equitable Trust Company ("Equitable"). This agreement allowed the Company to sell a portion of its insured origination to the MBS market using Equitable's status as an Office of the Superintendent of Financial Institutions ("OSFI") regulated company. This program has been very successful with over \$3 billion of NHA-MBS issued. In December 2007, the Company was approved by Canada Mortgage and Housing Corporation ("CMHC") as an issuer of NHA-MBS and as a seller into the Canada Mortgage Bond program ("CMB"), one of the first non-OSFI regulated Companies in Canada to be so approved. Issuer status will provide the Company with another funding source that it will be able to access independently. Perhaps more importantly, seller status for the CMB will give the Company direct access to the CMB which offers a relatively lower cost of funding as described below.

CANADA MORTGAGE BOND AS A NEW FUNDING SOURCE

The Canada Mortgage Bond program is an initiative introduced by Canada Mortgage and Housing Corporation whereby the Canada Housing Trust issues securities to investors in the form of semi-annual interest-yielding five-year bonds. The proceeds of these bonds are used to buy NHA-MBS. In the quarter ended September 30, 2006, the Company entered into an agreement with a Canadian bank which allowed the Company to indirectly sell a portion of the Company's residential mortgage origination into the September issue of the CMB. Pursuant to the same agreement, the Company indirectly sold smaller amounts into the December 2006 and September 2007 CMB issues. In December 2007, pursuant to the Company's approval as a seller into the CMB, the Company executed a direct sale of \$542 million into the issuance. Because of the similarities to a traditional Government of Canada bond (both have five-year unamortizing terms with a government guarantee), the CMB trades in the capital markets at a relatively modest premium to the yields on Government of Canada bonds. The Company's ability to sell into the CMB has given the Company access to lower costs of funds on both single-family and multi-family mortgage securitizations. Because these funding structures do not amortize, the Company can fund future mortgages through this channel as the original mortgages amortize or pay out. The Company also enjoys significant demand for mortgages from investment dealers that sell directly into the CMB.

FIRST NATIONAL MORTGAGE TRUST AS SPECIAL PURPOSE VEHICLE

In another initiative to increase gain on securitization revenue, the Company created a special purpose vehicle, First National Mortgage Trust ("FNMT"), in March 2006 for the purpose of financing its mortgages through the issuance of R-1(High) and R-1(Mid) rated ABCP directly in the Canadian public debt markets. The cost of funding through FNMT has been cheaper than the bank-sponsored alternatives since its inception; however, due to liquidity fears in the ABCP market, these costs began increasing dramatically in mid-August 2007. At that time, FNMT had \$477 million of ABCP issued. Despite the credit quality of the collateral funded by the Company through FNMT, which consisted of approximately 89% of insured prime mortgages, it became apparent that the liquidity fears associated with non-bank-sponsored ABCP issuers would extend to FNMT. The syndicate of bank-sponsored lenders, which has a pro rata interest in the same mortgage collateral funded by FNMT, became concerned and advised management of the mortgages to take immediate steps to ensure the continued liquidity of FNMT. This was achieved by selling related mortgage assets and refinancing some of FNMT's ABCP with bank-sponsored CP conduits. By November 6, 2007, FNMT had repaid the entire amount of its outstanding ABCP issuance. The speed and

efficiency with which these assets were sold and refinanced speaks to their quality and liquidity in the mortgage market. The Company plans to solely use bank-sponsored ABCP conduits for the foreseeable future to fund its ABCP requirements.

KEY PERFORMANCE INDICATORS

The principal indicators used to measure the Fund's performance are:

- Earnings before income taxes, depreciation and amortization after normalizing management compensation while the Company was a private entity ("Adjusted EBITDA"); and
- Distributable cash.

Adjusted EBITDA is not a recognized measure under GAAP. However, management believes that Adjusted EBITDA is a useful measure to provide investors with an indication of cash available for distribution prior to capital expenditures and income taxes. Adjusted EBITDA should not be construed as an alternative to net income determined in accordance with GAAP or to cash flows from operating, investing and financing activities. The Fund's method of calculating Adjusted EBITDA may differ from other issuers and, accordingly, Adjusted EBITDA may not be comparable to measures used by other issuers.

(in \$000s)	Three months ended		Year ended	
	December 31 2007	December 31 2006	December 31 2007	December 31 2006
For the Period				
Revenue	\$ 68,272	\$ 49,551	\$ 238,971	\$ 193,930
Net income	24,050	18,038	72,844	57,898
Adjusted EBITDA ⁽¹⁾	24,389	18,328	74,086	68,158
At Period End				
Total assets	460,336	393,016	460,336	393,016
Mortgages under administration	\$ 33,114,415	\$ 18,607,866	\$ 33,114,415	\$ 18,607,866

(1) This non-GAAP measure adjusts income before income taxes by adding back expenses for management compensation and interest expense on shareholder loans which consist primarily of distributions to shareholders while First National operated as a private company. This measure also includes a deduction in the year ended December 31, 2006 of \$750 (\$Nil for the quarter ended December 31, 2006) for normalized compensation for each of the two senior management executives based on compensation policies that took effect on closing of the initial public offering.

Distributable cash is not a defined term under GAAP. Management believes that net cash generated by the Fund prior to distribution is an important measure for investors to monitor. Management cautions investors that due to the Company's nature as a mortgage lender and securitizer, there will be significant variations in this measure from quarter to quarter as the Company collects and invests cash in mortgage securitizations. Accordingly, management believes that Adjusted EBITDA is a more relevant measure of the Company's performance. Distributable cash is determined by the Company as cash provided from operating activities increased/decreased by the change in mortgages accumulated for sale in the period and reduced by maintenance capital expenditures. Mortgages accumulated for sale consist primarily of mortgage loans that the Company funds on behalf of institutional investors on the day of the mortgage advance. A few days later, the Company aggregates all mortgages "warehoused" to date for each investor and receives a cash settlement. As the majority of mortgages are advanced in the last few days of a month, there are large amounts

of cash invested at quarter ends by the Company which are typically received in the first week of the subsequent quarter. The Company's credit facility provides full financing for the majority of these mortgage loans. Accordingly, management believes the measure of distributable cash is only meaningful if the change in mortgages accumulated for sale between reporting periods is accounted for in its determination.

In 2007, the Canadian Securities Administrators issued amended guidance for reporting by income trusts. This policy statement recommends various disclosures and, in particular, describes a new framework for measuring the amount of distributable cash generated by an income trust. The new guidance requires the determination of distributable cash to be reconciled to cash provided from operating activities. In disclosure prior to July 2007, the Company reconciled this measure from adjusted EBITDA. The Company has followed the new guidance, as described above, such that the comparative period calculations of distributable cash have been restated to reflect the current period's presentation.

DETERMINATION OF DISTRIBUTABLE CASH

(in \$000s)

	Three months ended		Year ended	
	December 31 2007	December 31 2006	December 31 2007	December 31 2006
For the Period				
Cash provided by (used in) operating activities	\$ 98,516	\$ 37,222	\$ 89,972	\$ (12,114)
Add (deduct):				
Provision for income taxes – current	–	–	–	8,710
Interest on shareholder loans	–	–	–	411
Working capital distribution	–	–	–	2,880
Change in tax payable balances	–	–	–	8,754
Change in mortgages accumulated for sale between periods	(83,308)	(29,881)	(14,632)	39,215
Less:				
Normalized management compensation	–	–	–	458
Public company expenses ⁽¹⁾	–	–	–	500
Maintenance capital expenditures	335	124	967	611
Distributable cash ⁽²⁾	\$ 14,873	\$ 7,217	\$ 74,373	\$ 46,287

(1) For the quarter and year ended December 31, 2006, these figures are pro-forma amounts to provide a suitable basis for comparison to the current quarter's actual figures.

(2) This non-GAAP measure adjusts Cash provided by (used in) operating activities by deducting public company expenses and maintenance capital expenditures. The comparative figures assume the Company incurred public company expenses in the prior period as described in the initial public offering prospectus.

REVENUES AND FUNDING SOURCES

Mortgage Origination

The Company derives a significant amount of its revenue from mortgage origination activities. The majority of mortgages originated are funded by either placement with institutional investors or sale to securitization conduits, in each case with retained servicing. Depending upon market conditions, either an institutional placement or a securitization conduit may be the most cost-effective means for the Company to fund individual mortgages. In general, originations are allocated from one funding source to another depending on market conditions and strategic considerations related to maintaining diversified funding sources. The Company retains servicing rights on virtually all of the mortgages it originates, which provides the Company with servicing fees to complement revenue earned through originations. For the year ended December 31, 2007, origination volume grew from \$7.3 billion to \$10.9 billion or 49% over the same period in the prior year. For the quarter ended December 31, 2007, origination volume grew from \$1.7 billion to \$2.8 billion or 65% over the same quarter in the prior year.

Placement Fees and Gain on Securitization

The Company recognizes revenue at the time that a mortgage is placed with an institutional investor or sold to a securitization conduit. Cash amounts received in excess of the mortgage principal at the time of placement are recognized in revenue as "Placement fees". The present value of additional amounts (excess spread) expected to be received over the remaining life of the mortgages sold (net of servicing and other costs) is recognized as a "Gain on securitization".

The excess spread on a mortgage is the difference between the interest rate on the mortgage and the yield earned by the investor after accounting for all anticipated prepayment provisions, servicing obligations and other costs. For Alt-A and small conventional multi-unit residential and commercial mortgages, the excess spread also includes assumptions for credit losses.

Upon the recognition of the "Gain on securitization", the Company establishes a "Securitization receivable" which is amortized as spread income is received by the Company. In addition, the Company is also required to establish a "servicing liability", which represents the future cost of servicing the securitized mortgages. As spread income is received by the Company, both the securitization receivable and the servicing liability are amortized accordingly. Residual securitization income consists of two components, a) the difference between the spread income received over time and the spread income assumed in the Company's derivation of securitization receivable; and b) the amortization of the servicing liability. The excess is attributable to better than expected cash flows being earned by the securitization than those anticipated when

gain on sale assumptions regarding prepayments, cost of funds, and credit losses were originally forecasted.

For all institutional placements and loans securitized through NHA-MBS and CMBS, the Company earns "Placement fees". In addition, under certain circumstances, additional revenue from institutional placements and NHA-MBS may be recognized as a "Gain on securitization". Revenues based on these originations are equal to either (1) the present value of the excess spread, or (2) an origination fee based on the outstanding principal amount of the mortgage. This revenue is received in cash at the time of placement. Of the Company's \$10.9 billion of originations for the year ended December 31, 2007, \$8.3 billion was placed with institutional investors, \$323 million was sold under the NHA-MBS program and \$335 million was originated for sale to CMBS conduits.

All loans securitized through the Company's ABCP program are recognized as a "Gain on securitization", as is a portion of the spread earned from NHA-MBS. Of the Company's \$10.9 billion of originations for the year ended December 31, 2007, \$1.9 billion was sold to ABCP conduits and other securitization vehicles, generating "Gain on securitization" revenue. The Company also acquires other significant amounts of mortgages for sale to its ABCP programs from other institutions. For the year ended December 31, 2007, the Company acquired \$152 million of such mortgages, entirely in the first quarter of the year.

In the past several years, the Company has experienced significant growth in mortgages funded through its securitization programs. As a result, revenue from "Gain on securitization" has increased accordingly. Since cash flows received from securitized assets are received over the life of the mortgage, and the revenue is recognized upon origination, there will be a timing difference between the recognition of revenue and the receipt of cash. This is similar to the common practice of most companies to record the revenue from sales at the time that goods are sold or shipped and set up a receivable until the cash is actually received.

The financial effect of the timing difference between the recognition of revenue and the receipt of cash is effectively equal to the "Gain on securitization" less "Amortization of securitization receivable" (net of "Amortization of servicing liability") in any given year. For the year ended December 31, 2007, the volume of mortgages funded through ABCP programs has increased. This timing difference required working capital funding of approximately \$21.2 million (\$18.3 million for the year ended December 31, 2006). To the extent that gains on securitization do not increase for a number of years, the effects of the timing difference would be neutralized as new securitization receivables would be offset by collections of existing securitization receivables.

Mortgage Servicing and Administration

The Company services virtually all mortgages generated through its mortgage origination activities on behalf of a wide range of institutional investors. Mortgage servicing and administration is a key component of the Company's overall business strategy and a significant source of continuing income and cash flow. In addition to pure servicing revenues, fees related to mortgage administration are earned by the Company throughout the mortgage term. Another aspect of servicing is the administration of funds held in trust including: borrower's property tax escrow, reserve escrows, and mortgage payments. As acknowl-

edged in the Company's agreements, any interest earned on these funds accrues to the Company as partial compensation for administration services provided. The Company has negotiated favourable interest rates on these funds with the chartered bank that maintains the deposit account, which has resulted in significant interest revenue.

In addition to the interest income earned on securitization receivables, the Company also earns interest income on mortgage-related assets, including mortgages accumulated for sale, mortgage and loan investments and purchased mortgage servicing rights.

RESULTS OF OPERATIONS

The following table shows the volume of mortgages originated by First National and mortgages under administration for the periods indicated.

(in \$ millions)	Three months ended		Year ended	
	December 31 2007	December 31 2006	December 31 2007	December 31 2006
Mortgage Originations by Asset Class				
Single-family residential	\$ 2,127	\$ 1,138	\$ 8,368	\$ 5,512
Multi-unit residential and commercial	635	580	2,508	1,798
Total originations	\$ 2,762	\$ 1,718	\$ 10,876	\$ 7,310
Funding of Mortgage Originations by Source				
Institutional investors	\$ 2,150	\$ 1,161	\$ 8,280	\$ 5,454
CMBS	3	115	335	407
NHA-MBS	133	22	323	173
Securitization and Company internal resources	476	420	1,938	1,276
Total	\$ 2,762	\$ 1,718	\$ 10,876	\$ 7,310
Mortgages under Administration				
Single-family residential	\$ 20,417	\$ 14,145	\$ 20,417	\$ 14,145
Multi-unit residential and commercial	12,697	10,214	12,697	10,214
Total	\$ 33,114	\$ 24,359	\$ 33,114	\$ 24,359

The Company experienced excellent mortgage origination growth in the year and quarter ended December 31, 2007. Total mortgage origination increased from \$7.3 billion in the comparative year of 2006 to \$10.9 billion for the year ended December 31, 2007, representing an increase of 49%. For the fourth quarter comparison, the growth between periods exceeded 60%. This growth reflects the Company's growing market share in the single-family residential mortgage broker channel and continued strength in Canada's commercial real estate market.

The increase in the cost of funding due to the volatility in the ABCP markets and the resulting fair value adjustment to the Company's securitization receivable offset what would have been a truly outstanding year for the Company. The year began with a well-bid market for asset-backed securities trading at tight spreads relative to risk-free benchmark

yields. During the third quarter, these spreads widened as fears related to US sub prime mortgages permeated all asset-backed securities markets. At the time the Company calculated the fair value adjustment, ABCP was trading at spreads approximately 0.50% above historical levels. Management decided to make an estimate of the possible impact of the credit tightening by adjusting its securitization models as if ABCP would trade at those elevated levels permanently. Consequently, a downward fair value adjustment of \$20.3 million related to the securitization receivable was recorded as a reduction of revenue in the third quarter. In addition to this amount, the Company has also recorded a downward fair value adjustment of \$2.6 million for mortgages accumulated for sale originated for the securitization market to reflect the widened spreads. Summing these two adjustments, a total downward adjustment of \$22.9 million related to securitization-related assets was recorded in

the third quarter. During the fourth quarter, ABCP spreads rose higher until this trend reversed dramatically in January 2008 with spreads narrowing rapidly such that by the end of the month, 30-day ABCP was trading only 0.10 percentage points higher than historical levels. The Company has remained conservative and at year end has assumed in the calculation of the fair value of its securitization receivable, that 30-day ABCP is 0.40 percentage points higher than historical levels.

Total revenues for the year ended December 31, 2007 compared to the same period in 2006 increased by 23% from \$193.9 million to \$238.8 million; however, revenues before fair value adjustments of \$24.4 million grew to \$263.3 million or 36% year-over-year. This growth resulted primarily from increased origination volume. Mortgage servicing revenue also grew due to the substantial increase in mortgages under administration.

The increase in ABCP funding costs has also affected the residual securitization component of this quarter's revenue. This was due to actual cash flows received since August 2007 being less than those implied in the securitization receivable. Gains on securitization revenue was affected in the fourth quarter only as the Company changed its assumptions used to determine gains on securitization related to increased ABCP costs beginning after the third quarter.

Placement Fees

Comparing the year ended December 31, 2007 to the same period ended December 31, 2006, placement fee revenue increased by 43% to \$129.9 million from \$90.8 million. This was largely due to the growth of mortgages originated for institutional placement which increased by 52% year-over-year, particularly from the residential segment, for which originations grew 54% year-over-year. Lending fees earned on Alt-A origination have also contributed approximately 4% to the increase in these fees. The growth from the increase in origination volume was mitigated by a change in product mix for residential mortgages. In the commercial segment, the Company suffered from changing credit markets in the CMBS market. In 2006, this was a well-bid market in which the Company earned revenues of \$7.5 million. During 2007, CMBS investors increasingly demanded higher spreads on issuances until the fall when the CMBS market deteriorated. As such the Company was able to sell into the CMBS market only in the first two quarters of the year, earning revenues of \$3.2 million. This change in the CMBS market accounted for a 5% drop in placement fees year-over-year. The credit environment also affected non CMBS commercial placement fees which increased by 1% from 2006 to 2007 as the Company earned smaller spreads on the higher volumes originated.

Gains on Securitization

Gains on securitization revenue increased by 26% to \$53.5 million from \$42.4 million. The increase was due to a variety of influences including: gains from indirect sales into the CMB program, higher Alt-A origination, and one-time gains related to large securitizations. The Company sells a portion of its residential origination volume to

institutional investors. In some cases the Company earns additional revenue over the term of the sold mortgages based on those investors' current funding rates. Because of the turmoil in the credit markets beginning in August 2007, funding rates dependent on Government of Canada bond yields decreased steadily to the end of the year. During the same period, prime mortgage rates increased, such that the spread between five-year fixed residential rates and similar term government bonds widened from 1.25 percentage points to more than 2.00 percentage points as at December 31, 2007. For these mortgages, the Company recorded \$8.0 million more gains on securitization than in the prior year.

Alt-A origination grew from \$467 million in 2006 to \$721 million in 2007, an increase of 54%. Although the cost of funding for the Alt-A program increased dramatically mid-way through the year, the Company was able to quickly increase the rates it offered to borrowers on the Alt-A product. The increase in volume contributed \$8.2 million in additional revenue related to gains on securitization.

In September 2006, the Company recorded a one-time \$7.2 million gain related to the securitization of a large portfolio of mortgages through a financial institution to use as collateral in the CMB. While the Company had gains on securitization related to sales through to the CMB in 2007, they were of smaller significance and represented a better execution of mortgage volume than would have been securitized elsewhere in the previous year. As reported in the first quarter of 2007, the Company purchased and securitized a single-family mortgage portfolio totaling \$152 million, which produced a one-time gain on securitization of \$3.3 million.

Lastly, gains on securitization decreased in the fourth quarter due to the increased credit spreads attributable to the credit market turmoil that began in August 2007. In particular, consistent with the Company's downward adjustment for securitization-related assets recorded in the third quarter, the Company assumed ABCP spreads were 0.50 percentage points higher than BAs for the calculation of gains on securitization in that quarter.

Mortgage Servicing Income

Mortgage servicing income increased by 38% to \$51.3 million from \$37.3 million, which was primarily due to the growth in the portfolio of mortgages under administration. This portfolio grew by 36% year-over-year, with the residential component growing by 44%. The residential component has a larger impact on servicing revenue as the price per unit is much higher than that on the commercial portfolio. Another aspect of this revenue is interest earned on funds held in trust. These funds are administered by the Company and include borrowers' property tax escrow. This income was \$11.8 million for the year ended December 31, 2007 and \$8.8 million for the 2006 comparative year. The growth was due to the increase in short-term interest rates and the amount of funds held in trust. At December 31, 2007 the amount of funds held in trust was \$325 million compared to \$287 million at December 31, 2006 and the average 30-day Canadian Dollar Offer Rate ("CDOR"), which is a benchmark for short-term interest rates, increased from 4.12% for 2006 to 4.54% for 2007.

Mortgage Investment Income

Mortgage investment income increased by 37% to \$21.3 million from \$15.5 million. This increase was due to increased investment in mortgage assets held on the balance sheet, including mortgages accumulated for sale, net securitization receivables, mortgage and loan investments and purchased mortgage servicing rights. These assets, excluding mortgages accumulated for sale, which turn over daily, increased by 29% from December 31, 2006 to December 31, 2007. This increase was augmented by a 6% increase in short-term interest rates during the year with the prime lending rate averaging 6.10% for the year ended December 31, 2007 versus 5.76% for the comparative period.

Residual Securitization Income

Residual securitization income decreased by 9% to \$7.3 million from \$8.0 million. The primary source of this revenue is the amortization of the servicing liability, which represents the servicing portion of the spread received from securitization conduits. The other source is the cash flows received in excess of the expected cash flows from securitization vehicles. The decrease is a result of two offsetting significant factors: (1) increased securitization receivables upon which these revenues are earned; and (2) tightened spreads in the securitization markets in the last five months, as discussed previously.

Because of increasing origination volumes of CMB, Alt-A, and small commercial mortgages, the securitization receivable has grown from \$77 million as at December 31, 2006 to \$89 million as at December 31, 2007, a growth rate of 16%. The additional revenue implied by this increase was offset by the compressed spreads related to funding securitization in the fourth quarter. The Company's fair market value adjustment for the widened ABCP spreads, as discussed previously, at the end of the third quarter effectively decreased the cash flows expected from these securitizations going forward. However, actual spreads for ABCP peaked at 0.65% above historical levels during the fourth quarter, negatively impacting the residual securitization income.

Second, the historical spread between prime lending rates and the cost of 30-day BAs was also abnormally compressed. This affects the Company as its floating rate mortgages use prime as a basis for its mortgage rates and it relies on funding tied to BAs in a significant portion of its securitizations. These two rates have historically exhibited a spread of approximately 1.65 percentage points, with prime being higher. Beginning in August 2007, this relationship changed as the cost of BAs increased relative to prime, such that the spread compressed to about 1.20 percentage points at its tightest in mid-September. Much like the cost of ABCP, this spread returned to historical norms of approximately 1.65 percentage points in January 2008. For the last five months of the 2007 year, the prime/BAs spread was compromised on average by 0.20 percentage points. The Company had approximately \$2.0 billion of securitized mortgages under administration at December 31, 2007 that ultimately depended on BAs as the basis of funding. Accordingly residual securitization income was reduced by approximately

\$1.7 million in 2007 because of this temporary spread compression.

This is in addition to an estimated decrease in revenue related to the fair market value adjustment recorded in the third quarter, discussed previously. The Company estimates that expected cash flows from affected securitization vehicles were reduced by \$1.0 million during this period.

Realized and Unrealized Losses on Financial Instruments

Effective January 1, 2007, the Company began to record realized and unrealized losses on financial instruments pursuant to new CICA section 3855. For First National, this line item typically consists of two components: (1) gains and losses related to holding term assets derived using discounted cash flow methodology and (2) those related to the Company's economic hedging activities. The term assets are affected by changes in credit markets and Government of Canada bond yields (which form the risk-free benchmarks used to price the Company's assets including the Company's investment in securitization receivables, cash collateral and subordinate notes held by securitization trusts, as well as swap derivatives). The Company does not attempt to hedge these assets and accordingly will experience potentially significant unrealized gains and losses as credit spreads change and bond yields fluctuate.

In addition to the fair value adjustment of \$20.3 million related to ABCP recorded in the third quarter mentioned previously, the impact of tightening credit markets also caused the deterioration of the CMBS market. As a result, the Company has determined that it is currently uneconomical to issue CMBS in Canada. The Company has accounted for this by adjusting downward the market value of the CMBS mortgages it held at December 31, 2007 by \$5.1 million, \$2.5 million of which was recorded in the fourth quarter. In the fourth quarter of 2007, the Company revised its estimate for the funding costs associated with ABCP to 0.40 percentage points higher than historical rates. The unrealized fair value gain that this adjustment produced has been offset with downward adjustments related to the valuation of credit enhancements required for the ABCP securitizations (primarily cash collateral) and the CMBS mortgages described above.

During the year, bond yields also declined as capital markets reacted to the credit environment and weakening economic data. The yield for five-year benchmark bonds decreased from approximately 4.60% as at December 31, 2006 to about 3.88% by the end of 2007. To adjust to fair market value, the Company decreased the rates at which it discounts the cash flows associated with its securitizations. While this accounted for some unrealized gains in fair market value in the year, implicitly the Company will now earn a lower rate of return on these assets going forward such that this gain is essentially an acceleration of accounting earnings otherwise earned in the future. The amount of cash flows to be received by the Company from the underlying securitization structures has not been affected by these changing bond yields. These gains and the mark to market of other financial assets and liabilities explain the remaining change of this component revenue.

Brokerage Fees Expense

Brokerage fees expense increased by 33% to \$102.9 million from \$77.6 million. The increase was due primarily to the increased single-family residential origination, which increased 52% year-over-year. As virtually all single-family mortgage originations are sourced through brokers, these percentage changes should be comparable. In the 2006 year, the Company expensed \$6.3 million of brokerage fees related to the origination of a portfolio of mortgages sold as CMB collateral. In 2007, the Company had two one-time items that affected brokerage expenses: \$2.8 million for the purchase of \$152 million of mortgages for securitization, and a \$1.5 million reduction related to the overaccrual of volume bonus expense related to 2006. Excluding these items, brokerage fees year-over-year would have increased by 46%. Additional savings are from product mix changes. In 2007, a change in product mix from longer-term originated mortgages to shorter-term also affected brokerage fee expense, reducing costs by approximately 5%.

Salaries and Benefits Expense

Salaries and benefits expense increased by 24% to \$34.9 million from \$28.1 million. To support the increase in mortgage origination and servicing a larger mortgage portfolio under administration, the Company increased staff levels. As at December 31, 2007, the Company had 448 employees compared to 352 as at December 31, 2006. The 27% increase in the number of employees and higher sales commissions payable to employees to generate the 52% increase in overall volume, explains this increase. Management salaries are paid to the two senior executives who own the Class B LP units indirectly. The current period's expense includes an increase to these management salaries as a result of the revised compensation arrangement executed on closing the initial public offering.

Interest Expense

Interest expense increased by 53% to \$13.2 million from \$8.6 million. This was primarily driven by increased use of the Company's credit facility for commercial mortgage investments and warehousing the larger origination volume that occurred during the year. As discussed in the "Liquidity and cash resources" section of this analysis, the Company warehouses a portion of the mortgages it originates prior to settlement with the ultimate investor. The Company uses the credit facility with its banking syndicate to fund the mortgages in this period.

Mortgage and loan investments increased by 54% year-over-year and origination of single-family mortgages increased 52%, both evidencing the higher interest expense. Overall borrowing costs were unaffected by the rate environment as average prime lending rates as described above, did not change significantly year-over-year. Interest on shareholders' loans is \$Nil in the current year as the related shareholder loans were repaid in March 2006.

Other Operating Expense

Other operating expense increased by 23% to \$13.7 million from \$11.1 million. The increase in these expenses was primarily due to the 36% increase in mortgages under administration year-over-year. The normalized growth of these expenses trails the growth in mortgages under administration, providing evidence of the economies of scale built into the Company's business model.

Provision for Income Taxes

Because the Company converted to a limited partnership from a corporation, the income before income taxes earned subsequent to the conversion date of June 15, 2006 does not attract tax at the partnership level. Accordingly, there is no provision for income taxes for the year ended December 31, 2007.

Net Income

Net income increased by 26% to \$72.8 million from \$57.9 million. The growth of earnings has lagged growth in mortgages under administration and origination due to the unrealized losses on securitization assets which comprise most of the \$24.3 million of fair value adjustments. Excluding these unrealized losses and provision for income taxes related to 2006, net income would have grown by 45% which is more consistent with the growth of mortgages under administration and origination volumes.

Adjusted EBITDA

Adjusted EBITDA increased by 9% to \$74.1 million from \$68.2 million. The increase was mitigated due to the unrealized losses on the securitization assets within the \$24.3 million of fair value adjustments. Excluding these unrealized losses, Adjusted EBITDA would have grown by 44%, which corresponds to the growth of mortgages under administration and origination.

OPERATING SEGMENT REVIEW

The Company aggregates its business from two segments for financial reporting purposes: (i) Residential (which includes single-family residential mortgages) and (ii) Commercial (which includes multi-unit and commercial mortgages), as summarized below.

Operating Business Segments

(in \$000s, except percent amounts)

Year ended	Residential		Commercial	
	December 31 2007	December 31 2006	December 31 2007	December 31 2006
Originations	\$ 8,368,000	\$ 5,512,000	\$ 2,508,000	\$ 1,798,000
Percentage change	51.8%		39.5%	
Revenue	\$ 194,478	\$ 142,762	\$ 44,492	\$ 51,168
Percentage change	36.2%		(13.0%)	
Income before income taxes and corporate non-allocated expenses	\$ 52,657	\$ 36,556	\$ 21,687	\$ 31,615
Percentage change	44.0%		(31.4%)	
Period ended	December 31 2007	December 31 2006	December 31 2007	December 31 2006
Identifiable assets	\$ 235,770	\$ 188,001	\$ 224,566	\$ 340,115
Mortgages under administration	\$ 20,417,446	\$ 14,145,311	\$ 12,696,969	\$ 10,214,170

RESIDENTIAL SEGMENT

Residential revenues have increased by 36% from the prior year primarily due to increased origination volumes. The increase has been offset by the fair value adjustment related to the residential-based securitization receivable. Without this adjustment of approximately \$14 million, and the \$7.2 million gain on securitization related to the Company's CMB execution in September 2006, revenue would have increased by 54%. This is consistent with the increase in origination of single-family mortgages of 52%. The income from this segment has decreased due to the fair value adjustments recorded in the current year. Excluding these adjustments, net income would have increased by 82%. This rate is reflective of the growth in origination volume and wider prime mortgage spreads in the last two quarters of 2007 that have driven higher gains on securitization.

Identifiable assets have increased due to increased single-family origination volumes which affect mortgages accumulated for sale, mortgage and loan investments, and securities purchased under resale agreements and owned. These securities are used by the Company to hedge outstanding Alt-A fixed mortgage rate commitments in the residential sector.

COMMERCIAL SEGMENT

Commercial revenues decreased by 13.0% from the prior year primarily due to the fair value adjustments related to the securitization receivable and mortgages accumulated for sale. Excluding these adjustments, revenue would have increased by 1.3%. This increase is below the commercial origination growth rate due to the deterioration of the

CMBS market, which caused revenue from CMBS to fall \$4.3 million year-over-year. Tighter margins on commercially-dependent placement fees also contributed to the decrease in revenues. For similar reasons, income before income taxes excluding the fair value adjustments grew by only 1.3% year-over-year.

Identifiable assets for the commercial sector decreased primarily due to decreased hedging requirements for funded and committed commercial mortgages. The Company had approximately \$112 million fewer securities held for resale for its commercial mortgages at the end of December 2007 compared to the end of December 2006.

LIQUIDITY AND CAPITAL RESOURCES

The Company's liquidity strategy has been to use bank credit to fund working capital requirements and to use cash flow from operations to fund longer-term assets, providing a relatively low leveraged balance sheet. The Company's credit facilities are typically drawn to fund: (1) mortgages accumulated for sale, (2) securitization receivables, and (3) mortgage and loan investments. The Company has a credit facility with a syndicate of five banks which provides for a total of \$300 million in financing. Bank indebtedness also includes borrowings obtained through securitization transactions, outstanding cheques, and overdraft facilities.

At December 31, 2007, outstanding bank indebtedness was \$198.5 million (December 31, 2006 – \$169.6 million) of which \$76.0 million (December 31, 2006 – \$90.7 million) was drawn to fund mortgages accumulated for sale. At December 31, 2007, the Company's other interest-yielding assets included: (1) securitization

receivables of \$88.9 million (December 31, 2006 – \$77.9 million) and (2) mortgage and loan investments of \$82.4 million (December 31, 2006 – \$53.2 million). The difference between bank indebtedness and mortgages accumulated for sale, which the Company considers a proxy for true leverage, has grown between December 2006 and December 2007 and now stands at \$122.5 million. This represents a debt to equity ratio of approximately 1.23 to 1 which the Company believes is still at a conservative level. This ratio has increased in part because of the reduction of equity in the last two quarters resulting from the fair value adjustments related to securitization assets. Excluding these adjustments, this ratio would have been 0.98 to 1. The ratio has also increased as the Company has taken advantage of opportunities to invest in mortgage and loan investments.

Despite the disruption in the ABCP market described previously, the Company continues to see demand for mortgage product from institutional investors and liquidity from bank-sponsored commercial paper conduits. The Company's strategy of using diverse funding sources has allowed the Company to remain profitable during the current credit environment.

The Company funds a portion of its mortgage originations with institutional placements and sales to securitization vehicles on the same day as the advance of the related mortgage. The remaining originations, primarily residential, are funded by the Company on behalf of institutional investors or securitization vehicles on the day of the advance of the mortgage. On specified days, typically weekly, the Company aggregates all mortgages "warehoused" to date for an institutional investor and transacts a settlement with that institutional investor. A similar process occurs for sales to securitization vehicles, although the Company can dictate the date of sale into the vehicle at its discretion. The Company uses a portion of the committed credit facility with the banking syndicate to fund the mortgages during this "warehouse" period. The credit facility is designed to be able to fund the highest balance of warehoused mortgages in a month and is normally only partially drawn.

The Company also invests in short-term mortgages, usually six to eighteen months, to bridge existing borrowers in the interim period between long-term financing solutions. The banking syndicate has provided credit facilities to partially fund these investments. As these investments return cash, it will be used to pay down this bank indebtedness. The syndicate has also provided credit to finance a portion of the Company's securitization receivables and other miscellaneous long term financing needs.

CAPITAL EXPENDITURES

First National's business is not a capital-intensive business. Historically, capital expenditures have included technology software and hardware, facility improvements and office furniture. In the year ended December 31, 2007, the Company purchased new computers, leasehold improvements, and office and communication equipment to support the growth of its single-family residential business, particularly its expansion into the Quebec market.

Going forward, the Company expects maintenance capital expenditures will be approximately \$1,000,000 annually and primarily relate to technology (software and hardware) maintenance. Maintenance capital expenditures are expected to be funded from operating cash flow.

SUMMARY OF CONTRACTUAL OBLIGATIONS

The Company's long-term obligations include five to ten year operating leases for its four offices across Canada, and its obligations for the ongoing servicing of mortgages sold to Trusts and mortgages related to servicing rights purchased. The Company sells its mortgages to Trusts and purchases servicing rights on a fully-serviced basis, and is responsible for the collection of the principal and interest payments on behalf of the Trusts, including the management and collection of mortgages in arrears.

Payments Due by Period

(in \$000s)

	Total	0–1 Years	1–3 Years	4–5 Years	After 5 Years
Lease obligations	\$ 12,230	\$ 3,075	\$ 6,056	\$ 2,615	\$ 484
Servicing liability	\$ 16,124	\$ 5,003	\$ 6,797	\$ 2,637	\$ 1,687
Total contractual obligations	\$ 28,354	\$ 8,078	\$ 12,853	\$ 5,252	\$ 2,171

GUARANTEES

First National Financial Operating Trust (the "Trust") and First National Financial GP Corporation (FNFLP's general partner, the "GP") have entered into postponement of claim and guarantees with respect to FNFLP's borrowings under its credit facility. The guarantee is supported by first ranking security over all the present and future assets of the Trust, including a first ranking pledge of all securities held by the Trust in FNFLP and the GP.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

FNFLP prepares its financial statements in accordance with GAAP, which requires management to make estimates, judgements and assumptions that management believes are reasonable based upon the information available. These estimates, judgements and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Management bases its estimates on historical experience and other assumptions, which it believes to be reasonable under the circumstances. Management also evaluates its estimates on an ongoing basis.

The significant accounting policies of First National are described in Note 2 to the audited financial statements prepared as at December 31, 2007 and modified for changes in accounting policies described below. The policies which First National believes are the most critical to aid in fully understanding and evaluating its reported financial results include the determination of the gain on securitization revenue and the impact of fair value accounting on financial instruments.

The Company uses estimates in valuing its gain or loss on the sale of its mortgages to special purpose entities ("Trusts") through securitizations. Under GAAP, valuing a gain on sale requires the use of estimates to determine the fair value of the retained interest (derived from the present value of expected future net cash flows) in the mortgages. The retained interest is reflected on the Company's balance sheet as securitization receivable.

On a quarterly basis, the Company reviews the estimates used to ensure their appropriateness and monitors the performance statistics of the relevant mortgage portfolios to adjust and improve these estimates. The estimates used reflect the expected performance of the mortgage portfolio over the life of the mortgages. The assumptions underlying the estimates used for the year and quarter ended December 31, 2007 continue to be consistent with those used for the nine-month period ended December 31, 2006 and the quarters ended March 31, 2007, June 30, 2007, and September 30, 2007, except for the prepayment rate assumption for the Alt-A fixed rate program, which the Company increased to 17% per annum in the quarter ended March 31, 2007. Inherent in the determination of the Company's securitization receivable is also an assumption about the relationship of short-term interest rates, specifically the spread between one-month BAs and one-month high quality ABCP. Historically the Company built its financial models with the assumption that the spread between these two rates would

always be quite narrow. By mid-October 2007, the spread between these instruments widened to approximately 50 basis points. As described previously, the Company has adjusted its securitization receivable to account for this change in circumstances.

The key assumptions used in the valuation of gain on sale are spread, prepayment rates, the annual expected credit losses, and the discount rate used to present value future expected residual cash flows. The annual rate of unscheduled principal payments is determined by reviewing portfolio prepayment experience on a monthly basis. The Company uses a rate of 16% for residential mortgages and 30% for commercial floating rate mortgages. The Company assumes there is no prepayment on commercial fixed rate mortgages. Credit losses are also reviewed on a monthly basis, in the context of the type of mortgages securitized. For the largest portion of the Company's securitizations, the mortgages are either insured or low ratio mortgages for which the Company does not provide for the event of a credit loss. For the securitization of Alt-A mortgages, the Company uses a credit loss rate of 0.35% per annum. For the securitization of small multi-unit residential and commercial mortgages, the Company uses a credit loss rate of 0.25% per annum. Both these rates are greater than the rates experienced by the Company to-date, but which management feels are appropriate estimates of losses that will average over the life of the mortgages being securitized.

In January 2007, the Company elected to treat its financial assets and liabilities, including securitization receivables, mortgages accumulated for sale, cash collateral and short term subordinated loans, and bonds sold short as held-for-trading. Essentially, this policy requires the Company to record changes in the fair value of these instruments in the current period's earnings. The Company's assets and liabilities are such that, in most cases, the Company must use valuation techniques based on assumptions that are not fully supported by observable market prices or rates.

CHANGES DURING 2007: FINANCIAL INSTRUMENTS, HEDGES AND COMPREHENSIVE INCOME

The Company has adopted three new accounting standards – "Financial Instruments – Recognition and Measurement", "Hedges", and "Comprehensive Income" beginning with the first quarter of the 2007 fiscal year. The principal impacts of the standards are detailed below:

- Financial assets and liabilities are required to be classified as available-for-sale, held-to-maturity, held-for-trading or loans and receivables. Such classification affects their carrying value and timing of recognition of unrecognized gains and losses. The standard that addresses this classification also permits an entity to designate any financial instrument as held-for-trading on initial recognition or adoption of this standard.
- For fair value hedges, where the Company is hedging changes in the fair value of assets and liabilities or firm commitments, the change in the value of derivatives and hedged items will be recorded through income.

The extent of these changes is described in the accounting policy note to the financial statements and in the section following. In summary the Company has designated financial instruments that are not derivatives as held-for-trading and recognized an adjustment to opening equity as at January 1, 2007 of \$2,680,000 which represents the net mark-to-market adjustment from net book value to fair value at that date. The change in mark-to-market for the year ended December 31, 2007 was a \$24.4 million loss. Disclosure has been made in Note 13 to the financial statements of the valuation methodologies and assumptions used in determining fair values of financial instruments.

FINANCIAL INSTRUMENTS

With the adoption of the new accounting standards surrounding financial instruments, the Company's income is subject to more volatility. This is particularly true for the securitization receivable together with the cash collateral and subordinate short-term notes held by securitization trusts. The Company had a choice between categorizing these assets as held-for-trading or available-for-sale. The accounting standard does not allow these assets to be treated as held-to-maturity, although this has always been the Company's intention. Each alternative available to the Company requires these assets to be recorded at their fair market value. The Company has elected to treat these assets as held-for-trading such that changes in market value are recorded in the statement of income. By electing to classify these assets as available-for-sale, the Company would be required to allocate mark-to-market amounts between "normal" income and comprehensive income. Management believes this would needlessly increase the complexity of the financial statements. Effectively, these assets will now be treated much like bonds, earning the Company a coupon at the different discount rates used by the Company. The discount rates used represent the sum of the coupon associated with a risk-free bond of the same duration plus a premium for the risk/uncertainty of the securitization's residual cash flows. As such, as rates in the bond market change, so will the recorded value of the Company's securitization related assets. These changes may be significant (favourable and unfavourable) from quarter to quarter. The Company has no intention of attempting to hedge this exposure due to the cost and complexity required to do so. Further, the Company does not intend to sell these assets before maturity. The adoption of the accounting standard has had no immediate impact on distributable cash.

The Company believes its hedging policies are suitably disciplined such that the related mark-to-market adjustments will be insignificant; however, in the event that effective hedging does not occur, the resulting gains and losses will be included in the current period's income. The Company uses bond forwards (consisting of bonds sold short and bonds purchased under resale agreements) to manage interest rate exposure between the time a mortgage rate is committed to the

borrower and the time the mortgage is sold to securitization trusts when the underlying cost of funding is fixed. As interest rates change, the value of these interest rate hedges varies inversely with the value of the mortgage contract. As interest rates increase, a gain will be recorded on the hedge which should be offset by a loss on the sale of the mortgage to the trusts as the mortgage rate committed to the borrower is fixed at the point of commitment. For residential mortgages, primarily mortgages for the Alt-A program, only a portion of the mortgage commitments issued by the Company eventually fund. The Company must assign a probability of funding to each mortgage in the pipeline and estimate how that probability changes as mortgages move through the various stages of the pipeline. The amount that is actually hedged is the expected value of mortgage fundings within the next 60 days (60 days being the standard maximum rate hold period available for the Alt-A program). As at December 31, 2007, the Company had entered into \$31.0 million in notional value forward bond sales for the Alt-A program. The current contracts were purchased in the period Oct 19, 2007 to December 5, 2007.

For multi-unit residential and commercial mortgages, the Company assumes all mortgages committed will fund and hedges each mortgage individually. This includes mortgages committed for the CMBS program as well as mortgages for sale to the Company's own securitization vehicles. As at December 31, 2007, the Company had entered into \$94.7 million in notional value forward bond sales. The current contracts were purchased during the period from December 19, 2006 to December 28, 2007.

The change in mark-to-market value of the hedges from January 1, 2007 to December 31, 2007 has been expensed through the statement of income as described in Notes 2 and 13 to the financial statements pursuant to the adoption of Section 3855.

The Company has also entered into interest rate swaps to immunize the Company's exposure to changing interest rates related to cash flows receivable from servicing rights. When the Company bids for servicing rights, particularly from CMBS issuances, it estimates the interest to be earned from receiving mortgage payments and holding them in trust until payable to the ultimate investor/transfer agent. This estimate requires the Company to use current short-term interest rates as a proxy for rates over a long-term period (typically ten years for CMBS). In order to lock in this rate and ensure the purchase price for the rights is not impaired in the future, the Company enters into interest rate swaps to remove the variability of changing short-term interest rates. As at December 31, 2007, the notional value of these swaps is \$7.0 million. Market swap rates rose then fell during the year, such that the net mark-to-market adjustment for the year was \$Nil. The amortizing swaps mature between April 2015 and July 2017.

FUTURE ACCOUNTING CHANGES**Capital Disclosures**

The CICA issued a new accounting standard, Section 1535, "Capital Disclosures", which requires the disclosure of both qualitative and quantitative information that enables users of financial statements to evaluate the entity's objectives, policies and processes for managing capital. This new standard will be effective for the Fund effective January 1, 2008.

Financial Instruments

The CICA issued two new accounting standards, Section 3862, "Financial Instruments – Disclosure", and Section 3863, "Financial Instruments – Presentation", which apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Fund and Partnership intend to adopt these new standards effective January 1, 2008. These standards will require the Company to disclose more information related to the financial instruments it has on its balance sheet.

RISK AND UNCERTAINTIES AFFECTING THE BUSINESS

The business, financial condition and results of operations of the Company are subject to a number of risks and uncertainties, and are affected by a number of factors outside the control of management of the Company including: ability to sustain performance and growth, reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers, changes in interest rates, repurchase obligations and breach of representations and warranties on mortgage sales, risk of servicer termination events and trigger events, cash collateral and retained interest, reliance on multi-unit residential and commercial mortgages, general economic conditions, government regulation, competition, reliance on mortgage insurers, reliance on key personnel, conduct and compensation of independent mortgage brokers, failure or unavailability of computer and data processing systems and software, insufficient insurance coverage, change in or loss of ratings, impact of natural disasters and other events, environmental liability, and risk related to Alt-A mortgages which experience higher arrears rates and credit losses than prime mortgages. In addition, risks associated with the structure of the Fund include those related to the dependence on FNFLP, leverage and restrictive covenants, cash distributions which are not guaranteed and will fluctuate with FNFLP's performance, the nature of Units, distribution of securities on redemption or termination of the Fund, restrictions on potential growth, unitholder liability, undiversified and illiquid holding in the Trust, the market price of Units, dilution of existing unitholders and FNFLP unitholders, statutory remedies, control of the Company and contractual restrictions and income tax matters. Risk and risk exposure are managed through a combination of insurance, a system of internal controls, and sound operating practices. The Company's key business model is to originate mortgages and find funding through various channels to earn ongoing

servicing or spread income. For the single-family residential segment, the Company relies on independent mortgage brokers for origination and several large institutional investors for sources of funding. These relationships are critical to the Company's success. For a more complete discussion of the risks affecting the Fund's business, reference should be made to the Annual Information Form of the Fund.

Income Tax Matters

On December 21, 2006, the Department of Finance (Canada) released draft legislation to implement proposals originally announced on October 31, 2006 pertaining to the taxation of certain income distributed by publicly traded trusts and the tax treatment of such distributions to unitholders (the SIFT Proposals). The SIFT Proposals were enacted on June 12, 2007 as proposed, and commencing in January 2011 (provided the Fund experiences only normal growth and no undue expansion before then), the Fund will be liable for tax at a rate comparable to the combined federal and provincial corporate tax rate on all or a significant portion of its income distributed to unitholders, and unitholders will receive Fund income distributions as taxable dividends. There can be no assurance that the final rules will not differ from the current legislation.

As the SIFT Proposals are now enacted as announced, the Fund will be required to account for future income taxes under the asset and liability method, whereby future income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Future income tax assets are recorded in the consolidated financial statements to the extent that realization of such benefits is more likely than not.

The SIFT Proposals will apply a tax at the trust level on distributions of certain income from publicly traded trusts at rate of tax comparable to the combined federal and provincial corporate tax rate and to treat such distributions as dividends to unitholders. Generally, existing trusts will have a four-year transition period and will not be subject to the new rules until 2011. However, assuming the SIFT Proposals are ultimately enacted in the form proposed, the implementation of such proposals would be expected to result in adverse tax consequences to the Fund and certain unitholders, may impact the future level of distributions made by the Fund, and may reduce the value of Fund units and hence increase the cost to the Fund of raising capital in the public capital markets.

Further, the Department of Finance (Canada) has indicated that, while there is no intention to prevent normal growth of existing trusts during the transition period, any undue expansion of a particular trust

could result in loss of the benefit of the transitional period. On December 15, 2006, the Department of Finance (Canada) issued guidelines with respect to what will be considered normal growth in this context. While the Fund does not intend to raise capital in excess of the safe harbour limits outlined in these guidelines, there is a risk that the adverse tax consequences resulting from the SIFT Proposals could be realized sooner than 2011.

FORWARD-LOOKING STATEMENTS

Forward-looking statements are included in this MD&A. In some cases, forward-looking information can be identified by the use of terms such as “may”, “will”, “should”, “expect”, “plan”, “anticipate”, “believe”, “intend”, “estimate”, “predict”, “potential”, “continue” or other similar expressions concerning matters that are not historical facts. Forward-looking information may relate to management's future outlook and anticipated events or results, and may include statements or information regarding the future financial position, business strategy and strategic goals, product development activities, projected costs and capital expenditures, financial results, risk management strategies, hedging activities, geographic expansion, licensing plans, taxes and other plans and objectives of or involving the Company. Particularly, information regarding growth objectives, any increase in mortgages under administration, future use of securitization vehicles, industry trends and future revenues is forward-looking information. Forward-looking information is based on certain factors and assumptions regarding, among other things, interest rate changes and responses to such changes, the demand for institutionally placed and securitized mortgages, the status of the applicable regulatory regime and the use of mortgage brokers for single-family residential mortgages. These forward-looking statements should not be read as guarantees of future performance or results, and will not necessarily be accurate indications of whether or not, or the times by which, those results will be achieved. While management considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect. Forward-looking information is subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management currently expects. These factors include reliance on sources of funding, concentration of institutional investors, reliance on independent mortgage brokers and changes in interest rates outlined under “Risk and Uncertainties Affecting the Business”. In evaluating these statements, the reader should specifically consider various factors, including the risks outlined under “Risk and Uncertainties Affecting the Business”, which may cause actual events or results to differ materially from any forward-looking statement. The forward-looking statements contained in this discussion represent management's expectations as of March 4, 2008, and are subject to change after such date. However, management and the Fund disclaim any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required under applicable securities regulations.

OUTLOOK

After reviewing our performance and the financial results for the fourth quarter and year ended December 31, 2007, the Company continues to believe that the outlook is favourable. Nonetheless, the third quarter demonstrated that market conditions can change quickly, making future conditions difficult to predict.

The recent increase in funding costs for mortgage assets funded through the securitization market has been reflected in the current year's financial results. The Company has:

- adjusted its securitization receivable to account for ABCP costs that were 0.40 percentage points higher than historical levels as at December 31;
- decreased the value of CMBS mortgages to fair value; and
- realized lower cash flows from the compressed prime/BAs spread.

At the time of writing, the following changes have occurred:

- ABCP is trading at 0.10 percentage points higher than historical rates;
- the Company's obligations for funding new CMBS mortgages ended in the fourth quarter; and
- the prime/BAs spread has returned to its traditional level.

If there is no further deterioration in these markets, no further downward adjustments will be required. In addition, spreads on prime mortgages have recently widened significantly as bond yields have declined while mortgage rates have remained relatively static. This will give the Company an opportunity to increase earnings on its main area of focus – the prime single-family residential mortgage market.

The Company was approved by Canada Mortgage and Housing Corporation (CMHC) to become an Approved Issuer pursuant to the NHA-MBS program and an Approved Seller to the Canada Mortgage Bond (CMB) program. The Company believes that having the ability to directly issue NHA-MBS for inclusion in the CMB program will lower its overall cost of funding mortgages and increase its funding source diversification.

Management believes that housing continues to be affordable by historical standards, although less so than in previous quarters due to price increases and tightened credit conditions. The economy, which is the principal driver of the single-family residential housing market, continues to grow, albeit not as strongly as previously experienced. In addition, the mortgage broker distribution channel continues to show strong rates of growth. In summary, strength in residential mortgage origination volume is expected to continue in 2008.

Mortgage assets under administration are expected to exhibit double-digit growth over the next 12 months led by the Company's own originations.

Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements of First National Financial Income Fund for the period January 1, 2007 to December 31, 2007 and the financial statements of First National Financial LP for the period January 1, 2007 to December 31, 2007 were prepared by management and all information in this annual report is the responsibility of management.

The financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. The preparation of these financial statements requires management to make estimates and assumptions that affect certain reported amounts which management believes are reasonable.

The Audit Committee of the Board of Directors has reviewed in detail the financial statements with management and the independent auditor. The Board of Directors has approved the financial statements on the recommendation of the Audit Committee.

Ernst & Young LLP, an independent auditing firm, has audited First National Financial Income Fund's 2007 consolidated financial statements and First National Financial LP's 2007 financial statements in accordance with Canadian generally accepted auditing standards and has provided independent audit opinions. The auditors have full and unrestricted access to the Audit Committee to discuss the results of their audits.



Stephen Smith
Chairman and President



Robert Inglis
Vice President, Finance

Auditors' Report

To the Unitholders of
First National Financial Income Fund

We have audited the consolidated balance sheets of **First National Financial Income Fund** as at December 31, 2007 and 2006 and the consolidated statements of income (loss) and unitholders' equity and cash flows for the year ended December 31, 2007 and the period from April 19, 2006, the date of the Declaration of Trust, to December 31, 2006. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the year ended December 31, 2007 and the period from April 19, 2006 to December 31, 2006 in accordance with Canadian generally accepted accounting principles.

The signature of Ernst & Young LLP is written in a cursive, handwritten style.

Chartered Accountants
Licensed Public Accountants

Toronto, Canada
February 25, 2008

First National Financial Income Fund Consolidated Balance Sheets

(in \$000s)

As at December 31	2007	2006
ASSETS		
Distributions receivable	\$ 1,937	\$ 934
Investment in First National Financial LP (note 4)	101,752	109,483
	103,689	110,417
LIABILITIES AND EQUITY		
Liabilities		
Distributions payable	1,937	934
Accounts payable and accrued liabilities	37	13
Future income taxes (note 6)	7,700	–
Total liabilities	9,674	947
Equity		
Unitholders' equity	94,015	109,470
	\$ 103,689	\$ 110,417

See accompanying notes

Approved by the Trustees:



Trustee
John Brough



Trustee
Robert Mitchell

First National Financial Income Fund
Consolidated Statements of Income (Loss) and Unitholders' Equity

(in \$000s, except per unit amounts and number of units)

	Year ended December 31 2007	Period from April 19 2006 to December 31 2006
REVENUE		
Equity income from investment in First National Financial LP	\$ 6,547	\$ 3,915
EXPENSES		
Trust administration expenses	24	13
Income before income taxes	6,523	3,902
Provision for future income taxes (note 6)	7,700	-
Net income (loss) for the period	\$ (1,177)	\$ 3,902
Unitholders' equity, beginning of period	109,470	-
Unitholders' equity, initial amount	-	1
Redemption	-	(1)
Issued pursuant to initial public offering on June 15, 2006	-	99,640
Issued pursuant to over-allotment option	-	12,000
Distributions (note 5)	(14,278)	(6,072)
Unitholders' equity, end of period	\$ 94,015	\$ 109,470
Average number of units outstanding during the period	11,800,000	11,643,216
Earnings (loss) per unit (note 8)		
Basic	\$ (0.10)	\$ 0.34

See accompanying notes

First National Financial Income Fund Consolidated Statements of Cash Flows

(in \$000s)

	Year ended December 31 2007	Period from April 19 2006 to December 31 2006
OPERATING ACTIVITIES		
Net income (loss) for the period	\$ (1,177)	\$ 3,902
Add (deduct) items not involving cash		
Provision for future income taxes	7,700	–
Equity income from investment in First National Financial LP	(6,547)	(3,915)
Distributions received from First National Financial LP	13,275	5,138
	13,251	5,125
Net change in non-cash working capital balances related to operations	24	13
Cash provided by operating activities	13,275	5,138
INVESTING ACTIVITIES		
Investment in First National Financial LP	\$ –	\$ (111,640)
Cash used in investing activities	–	(111,640)
FINANCING ACTIVITIES		
Issuance of Fund Units	–	111,640
Distributions paid	\$ (13,275)	\$ (5,138)
Cash provided by (used in) financing activities	(13,275)	106,502
Net change in cash during the period and cash equivalents, end of period	\$ –	\$ –

See accompanying notes

First National Financial Income Fund

Notes to Consolidated Financial Statements

December 31, 2007

(in \$000s, except per unit amounts)

NOTE 1

Organization and Business of the Fund

First National Financial Income Fund [the “Fund”] is an unincorporated, open-ended trust established under the laws of the Province of Ontario on April 19, 2006, pursuant to a Declaration of Trust. The Fund was established to acquire and hold, through a newly constituted wholly owned trust, First National Financial Operating Trust [the “Trust”], investments in the outstanding limited partnership units of First National Financial LP [“FNFLP”]. Pursuant to an underwriting agreement dated June 6, 2006 and initial public offering dated June 15, 2006, the Fund sold 10,600,000 units of the Fund [“Fund Units”, “Units” or “Unit”], at a price of \$10.00 per Unit for proceeds totalling \$106,000. The proceeds of the offering, net of underwriters’ fees of \$6,360, were used to partially fund the indirect acquisition [through the Trust] by the Fund of a 17.94% interest in FNFLP, through the issuance of 10,600,000 Class A LP Units by FNFLP.

Concurrent with the initial public offering and as part of the acquisition agreement between the Fund, FNFLP and First National Financial Corporation [“FNFC” or the “predecessor”], on June 15, 2006, FNFLP purchased all of FNFC’s assets and assumed its liabilities, except for income tax liabilities. The consideration for this purchase was:

- the issuance of 48,486,316 exchangeable Class B LP units;
- an acquisition promissory note of \$97,140, of which \$10,940 has been accounted for as a distribution in FNFLP’s financial statements; and
- a working capital note in the amount of \$6,339, representing the difference between the net assets of FNFC as at March 31, 2006, excluding tax liabilities, and the net assets transferred to FNFLP as at June 14, 2006. The issuance of this note has also been accounted for as a distribution in FNFLP’s financial statements.

The exchangeable Class B LP units retained by FNFC are exchangeable on a one-for-one basis for units of the Fund at any time at the option of FNFC. FNFLP is managed by First National Financial GP Corporation, the general partner, which holds a 0.01% interest in FNFLP. The Fund initially owned 17.94% of the shares of First National Financial GP Corporation and FNFC wholly-owned the remaining 82.06%. The ownership of the general partner will change pro rata as the exchangeable Class B LP units are exchanged for units in the Fund.

On July 11, 2006, the underwriters exercised an over-allotment option to purchase 1,200,000 Units of the Fund at \$10.00 per unit from FNFC. Accordingly, as at December 31, 2006 and 2007, the Fund indirectly holds a 19.97% interest in FNFLP and FNFC holds an 80.03% controlling interest in FNFLP.

The Class A LP unitholders and the exchangeable Class B LP unitholders of FNFLP are entitled to one vote for each unit held at all meetings of holders of the LP units and have economic rights that are equivalent in all material respects, except that exchangeable Class B LP units are exchangeable, directly or indirectly, on a one-for-one basis

[subject to customary anti-dilution provisions] for Fund Units at the option of the holder at any time. Additionally, exchangeable Class B LP units have special voting rights that entitle the holder to receive notice of, attend and vote at all meetings of unitholders of the Fund.

The Fund effectively commenced operations through its indirect investment in FNFLP on June 15, 2006. The excess of the Fund’s cost of its investments in units of FNFLP over the carrying value of the underlying net assets has been assigned to goodwill and finite life intangible assets. Income reported by the Fund commenced on the acquisition date.

NOTE 2

Basis of Presentation and Significant Accounting Policies

BASIS OF PRESENTATION

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles.

These consolidated financial statements should be read in conjunction with the audited December 31, 2007 financial statements of FNFLP.

INCOME TAXES

Accounting for income taxes is reflected in these consolidated financial statements on the assumption that the Fund will qualify as a “mutual fund trust” as defined in the Income Tax Act (Canada) [the “Tax Act”], including its establishment and maintenance as a trust for the benefit of Canadian residents. Consequently, these consolidated financial statements do not reflect any provision for current income taxes as the Fund intends to distribute to its unitholders substantially all of its taxable income and the Fund intends to comply with the provisions of the Tax Act that permit, among other items, the deduction of distributions to unitholders from the Fund’s taxable income.

The Fund accounts for income taxes in accordance with the liability method. Under this method, future income tax assets and liabilities are determined based on temporary differences between the carrying amounts and tax bases of assets and liabilities, and measured using the substantively enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. The effect on future income taxes of a change in tax rates is recognized in income in the period that includes the date of substantial enactment. A valuation allowance is established, if necessary, to reduce future income tax assets to the amount that is more likely than not to be realized.

INVESTMENTS IN FNFLP AND FIRST NATIONAL FINANCIAL GP CORPORATION

The Fund accounts for its investments in FNFLP and First National Financial GP Corporation using the equity method. Under this method, the cost of the investment is increased by the Fund’s proportionate share of FNFLP’s earnings and reduced by any distribution paid to the Fund by FNFLP and amortization of the portion of the purchase price discrepancy, consisting of intangible assets.

EXCESS OF PURCHASE PRICE OVER THE CARRYING VALUE OF ASSETS

The excess of the Fund's cost of its investment in units over the carrying value of the underlying net assets has been allocated to servicing rights, FNFLP's broker and borrower relationships and goodwill. The excess related to servicing rights is being amortized over the average term of the related mortgages and the excess related to broker and borrower relationships over the estimated useful term of 5 and 10 years of the relationships. The goodwill component of the purchase price discrepancy will not be amortized. The value of the assets will be tested annually for impairment.

NOTE 3

Fund Units

The Fund may issue an unlimited number of units for consideration and on terms and conditions as determined by the Fund's trustees. Each Fund Unit is transferable and represents an equal undivided beneficial interest in any distribution from the Fund. All Fund Units are of the same class and have equal rights and privileges.

In connection with the initial public offering, the Fund issued 10,600,000 Fund Units on June 15, 2006 at a price of \$10.00 per Unit. On July 11, 2006, subject to the over-allotment option, the Fund issued 1,200,000 additional Fund Units at \$10.00 per Unit.

Under the terms of the Exchange, Voting and Registration Rights Agreement dated June 15, 2006, the exchangeable Class B LP units held by FNFC are exchangeable for Fund Units on a one-for-one basis. After exercise of the over-allotment options, the Fund has reserved 47,286,316 Units for the exchange of the exchangeable Class B LP units.

Fund Units are redeemable at any time on demand by the unitholder. The redemption price per Unit is equal to the lesser of:

- 90% of the weighted average trading price per Unit during the last 10 days on the principal exchange on which the Units are listed; or
- An amount equal to:
 - the closing price of the Units on the date on which the Units were tendered for redemption on the principal stock exchange on which the Units are listed, if there was a trade on the specified date and the applicable market or exchange provides a closing price; or
 - the average of the highest and lowest prices of the Units on the date on which the Units were tendered for redemption on the principal stock exchange on which the Units are listed, if there was trading on the date on which the Units were tendered for redemption and the exchange or other market provides only the highest and lowest trade prices of the Units traded on a particular day; or
 - the average of the last bid and ask prices quoted in respect of the Units on the principal stock exchange on which the Units are listed if there was no trading on the date on which the Units were tendered for redemption.

NOTE 4

Investment in First National Financial LP

Investment in First National Financial LP consists of the following:

	2007	2006
Units outstanding	\$ 111,640	\$ 111,640
Equity accounting adjustments		
Balance, beginning of period	(2,157)	–
Equity earnings of First National Financial LP for the period	14,547	7,915
Amortization of purchase price discrepancy	(8,000)	(4,000)
Distributions for the period	(14,278)	(6,072)
Balance, end of period	\$ 101,752	\$ 109,483

NOTE 5

Distributions to Unitholders

The Fund is entirely dependent on distributions from FNFLP to make its own distributions. The Fund pays monthly distributions to its unitholders of record on the last business day of each month approximately 15 days after the end of each month. The table below outlines the cumulative distributions to unitholders:

	Per unit	Amount
Distributions paid		
January 31, 2007	\$ 0.07917	\$ 934
February 28, 2007	0.07917	934
March 31, 2007	0.07917	934
April 30, 2007	0.07917	935
May 31, 2007	0.10417	1,229
June 30, 2007	0.10417	1,229
July 31, 2007	0.10417	1,229
August 31, 2007	0.10417	1,229
September 30, 2007	0.10417	1,229
October 31, 2007	0.10417	1,229
November 30, 2007	0.10417	1,230
Distributions payable		
December 31, 2007	0.16417	1,937
	\$ 1.21004	\$ 14,278

NOTE 6

Income Taxes

In June 2007, the Government of Canada enacted new legislation imposing additional income taxes upon publicly traded income trusts, including the Fund, effective January 1, 2011. Prior to June 2007, the Trust estimated the future income taxes on certain temporary differences between amounts recorded on its consolidated balance sheet for book and tax purposes at a Nil effective tax rate. Under the legislation and general federal corporate rate reductions announced in December 2007, the Trust now estimates the effective tax rate on the post 2010 reversal of these temporary differences to be 29.5% to December 31, 2011 and 28% thereafter. Temporary differences reversing before 2011 will still give rise to Nil future income taxes.

The change in future tax rates has led to two consequences for the Fund's consolidated financial statements: [i] the Fund has provided for a future income tax liability on the anticipated net book value and tax carrying cost difference as at January 1, 2011 related to the servicing rights and underwriting system assets listed in note 2, and [ii] the Fund has accounted for temporary tax differences implicit in its investment in FNFLP.

On the first issue, because there is a difference between the accounting carrying value of these intangible assets and their underlying tax carrying value, Canadian generally accepted accounting principles require a future income tax liability to be accrued. This was accrued on the initial public offering based on tax rates for income trusts, which at that time was a rate of Nil. With new rates being enacted in June 2007 and December 2007, the effective tax rate as at January 1, 2011 was changed to 29.5% and the effective tax rate as at January 1, 2012 was changed to 28%. Based on these new tax rates, the Fund accrued a future income tax liability of \$9,000 as at June 30, 2007, reduced to \$8,200 at December 31, 2007. This liability will, in all likelihood, remain at this amount until January 1, 2011, when it will be drawn down every quarter as the Fund continues to amortize the related intangible assets until 2016.

In June 2007, based on the assets and liabilities of FNFLP, the Fund began estimating its portion of the amount of the temporary differences which were previously not subject to tax and has estimated the periods in which these differences will reverse. The Fund estimates that as at December 31, 2007, \$1,863 of net taxable temporary differences will reverse after January 1, 2011, resulting in a \$500 future income tax asset. The temporary differences relate principally to the excess of net tax carrying values of the securitization receivable, servicing liability, purchased mortgage servicing rights and intangible assets recorded in the financial statements of FNFLP over the net book value of those assets.

While the Fund believes it will be subject to additional tax under the new legislation, the estimated effective tax rate on temporary difference reversals after 2011 may change in future periods. As the legislation is new, future technical interpretations of the legislation could occur and could materially affect management's estimate of the future income tax liability.

The amount and timing of reversals of temporary differences will also depend on the Fund's future operating results, acquisitions and dispositions of assets and liabilities, and distribution policy. A significant change in any of the preceding assumptions could materially affect the Fund's estimate of the net future income tax liability.

NOTE 7

Guarantee

The Fund's wholly-owned subsidiary, First National Financial Operating Trust, has provided guarantees to and subordinated its rights to receive payments from FNFLP in respect of FNFLP's bank credit facility that had an outstanding amount at December 31, 2007 of \$182,200 [2006 – \$116,900] and an authorized limit of \$300,000 [2006 – \$200,000].

NOTE 8

Earnings (Loss) per Unit

Earnings (loss) per unit are calculated using net income (loss) for the period divided by the number of Fund Units outstanding.

Auditors' Report

To the Partners of
First National Financial LP

We have audited the balance sheets of **First National Financial LP** as at December 31, 2007 and 2006 and the statements of income and retained earnings, changes in equity and cash flows for the year ended December 31, 2007 and the nine-month period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the year ended December 31, 2007 and the nine-month period ended December 31, 2006 in accordance with Canadian generally accepted accounting principles.

Toronto, Canada
February 25, 2008

Ernst + Young LLP

Chartered Accountants
Licensed Public Accountants

First National Financial LP

Balance Sheets

(in \$000s)

As at December 31	2007	2006
ASSETS		
Accounts receivable and sundry	\$ 19,908	\$ 16,846
Mortgages accumulated for sale	76,037	90,669
Securitization receivable (note 3)	88,918	77,949
Cash collateral and short-term notes held by securitization trusts (note 3)	55,574	45,489
Mortgage and loan investments (note 4)	82,353	53,230
Purchased mortgage servicing rights (note 5)	9,754	7,267
Securities purchased under resale agreements and owned (note 11)	122,864	232,952
Capital assets, net (note 6)	4,928	3,714
Total assets	460,336	528,116
LIABILITIES AND EQUITY		
Liabilities		
Bank indebtedness (note 7)	\$ 198,500	\$ 169,638
Accounts payable and accrued liabilities	22,596	14,487
Servicing liability (note 3)	16,124	15,038
Securities sold under repurchase agreements and sold short (note 11)	123,088	232,952
Total current liabilities	360,308	432,115
Total liabilities	360,308	432,115
Equity		
Commitments and guarantees (note 10)		
GP units (note 1)	59	59
Class A LP units (note 1)	109,140	109,140
Exchangeable Class B LP units (note 1)	(22,940)	(22,940)
Shareholders' equity – predecessor (note 1)	–	–
Retained earnings	13,769	9,742
Total equity	100,028	96,001
Total liabilities and equity	\$ 460,336	\$ 528,116

See accompanying notes

Approved on behalf of the Board:



Director
Stephen Smith



Director
Moray Tawse

First National Financial LP

Statements of Income and Retained Earnings

(in \$000s, except earnings per unit)

	Year ended December 31 2007	Nine-month period ended December 31 2006	Twelve-month period ended December 31 2006 [unaudited]
REVENUE			
Placement fees	\$ 129,926	\$ 73,069	\$ 90,830
Gains on securitization (note 3)	53,517	37,804	42,398
Mortgage investment income	21,331	11,444	15,490
Mortgage servicing income	51,252	29,154	37,253
Residual securitization income (note 3)	7,276	4,956	7,959
Realized and unrealized losses on financial instruments (note 5)	(24,331)	-	-
	238,971	156,427	193,930
EXPENSES			
Brokerage fees	\$ 102,886	\$ 67,891	\$ 77,607
Salaries and benefits	34,858	21,317	28,064
Interest	13,205	7,022	8,565
Interest on shareholders' loans	-	-	411
Management salaries	1,500	917	1,042
Other operating expenses	13,678	8,554	11,112
	166,127	105,701	126,801
Income before income taxes	72,844	50,726	67,129
Provision for (recovery of) income taxes (note 9)			
Current	-	4,239	8,710
Future	-	(927)	521
	-	3,312	9,231
Net income for the period	\$ 72,844	\$ 47,414	\$ 57,898
Retained earnings, beginning of period	9,742	-	-
Add: Transitional adjustment on adoption of financial instruments standards (note 2)	2,680	-	-
Less: Income earned by predecessor corporation	-	(7,266)	(17,750)
Less: Distributions declared	(71,497)	(30,406)	(30,406)
Retained earnings, end of period	\$ 13,769	\$ 9,742	\$ 9,742
Earnings per unit (note 1.5)			
Basic	\$1.23	\$0.80	\$0.98

See accompanying notes

First National Financial LP Statements of Cash Flows

(in \$000s)

	Year ended December 31 2007	Nine-month period ended December 31 2006	Twelve-month period ended December 31 2006 [unaudited]
OPERATING ACTIVITIES			
Net income for the period	\$ 72,844	\$ 47,414	\$ 57,898
Add (deduct) items not affecting cash			
Gains on securitization	(53,874)	(37,804)	(42,398)
Amortization of securitization receivable	38,656	21,839	29,499
Amortization of purchased mortgage servicing rights	726	502	722
Amortization of capital assets	1,242	803	1,076
Realized and unrealized losses on financial instruments	24,331	–	–
Amortization of servicing liability	(5,962)	(4,135)	(5,444)
Future income taxes	–	(927)	521
	77,963	27,692	41,874
Net change in non-cash working capital balances related to operations (note 12)	12,008	(63,778)	(53,988)
Cash provided by (used in) operating activities	89,971	(36,086)	(12,114)
INVESTING ACTIVITIES			
Additions to capital assets	\$ (2,456)	\$ (1,036)	\$ (1,261)
Acquisition of FNFC business	–	(97,140)	(97,140)
Investment in cash collateral and short-term notes, net	(14,898)	(22,100)	(20,215)
Investment in mortgage and loan investments	(119,196)	(46,428)	(52,542)
Mortgage and loan investments	90,073	29,969	38,076
Investment in purchased mortgage servicing rights	(3,213)	(1,391)	(2,210)
Cash used in investing activities	(49,690)	(138,126)	(135,292)
FINANCING ACTIVITIES			
Issuance of Class A LP units (note 1)	\$ –	\$ 109,140	\$ 109,140
Issuance of GP units (note 1)	–	59	59
Distributions paid	(66,475)	(25,728)	(25,728)
Shareholders' loans	–	–	(13,700)
Exercise of over-allotment option	–	(12,000)	(12,000)
Distribution related to working capital adjustment	–	(6,339)	(6,339)
Securities purchased under resale agreements and owned	110,088	(132,349)	(29,207)
Securities sold under repurchase agreements and sold short	(112,756)	132,349	29,207
Cash provided by (used in) financing activities	(69,143)	65,132	51,432
Net increase in bank indebtedness during the period	(28,862)	(109,080)	(95,974)
Bank indebtedness, beginning of period	(169,638)	(60,558)	(73,664)
Bank indebtedness, end of period	(198,500)	(169,638)	(169,638)
Supplemental cash flow information			
Income taxes paid	–	15,794	16,538
Interest paid	\$ 12,989	\$ 7,022	\$ 10,277

See accompanying notes

First National Financial LP Statements of Changes in Equity

(in \$000s)

	2007		Nine-month period ended December 31 2006
	Number of Units	Year ended December 31 2007	
GP units			
Balance, beginning of period	59,092	\$ 59	\$ –
Issued upon formation (note 1)	–	–	59
Balance, end of period	59,092	\$ 59	\$ 59
Class A LP units			
Balance, beginning of year	11,800,000	\$ 109,140	\$ –
Issued upon acquisition of FNFC business (note 1)	–	–	97,140
Issued upon exercise of over-allotment option (note 1)	–	–	12,000
Balance, end of period	11,800,000	\$ 109,140	\$ 109,140
Exchangeable Class B LP units			
Balance, beginning of period	–	\$ (22,940)	\$ –
Transfer of excess of purchase price over net book value to exchangeable Class B LP units upon acquisition of FNFC business (note 1)	48,486,316	–	(10,940)
Repurchased upon exercise of over-allotment option	(1,200,000)	–	(12,000)
Balance, end of period	47,286,316	\$ (22,940)	\$ (22,940)
Shareholders' equity – predecessor			
Balance, beginning of period	2	\$ –	\$ 68,318
Net income for the year			7,266
Distribution related to working capital adjustment			(6,339)
Paid to FNFC on acquisition of FNFC business			(97,140)
Future income tax liabilities applicable to predecessor not assumed by the partnership on acquisition (note 1)			16,955
Transfer of excess of purchase price over net book value to exchangeable Class B LP units upon acquisition of FNFC business (note 1)	(2)	–	10,940
Balance, end of period	–	\$ –	\$ –

See accompanying notes

First National Financial LP Notes to Financial Statements

December 31, 2007

(in \$000s, except per unit amounts or unless otherwise noted)

NOTE 1

General Organization and Business of First National Financial LP

First National Financial LP [the “Company” or “FNFLP”], a limited partnership established under the laws of Ontario, is a Canadian-based originator, underwriter and servicer of predominantly prime single-family residential and multi-unit residential and commercial mortgages.

As a Canada Mortgage and Housing Corporation approved lender, the Company is active in the single-family residential and commercial mortgage markets. As at December 31, 2007, the Company had mortgages under administration of \$33,114,415 [2006 – \$24,359,481] and cash held in trust of \$324,915 [2006 – \$287,382]. Mortgages under administration are serviced for financial institutions such as insurance companies, pension funds, mutual funds, trust companies, credit unions and special purpose entities [including trusts], also referred to as securitization vehicles. As at December 31, 2007, the Company administered 109,909 mortgages [2006 – 83,098] for 109 institutional investors [2006 – 106] with an average remaining term to maturity of 57 months [2006 – 60 months].

First National Financial Income Fund [the “Fund”] owns an indirect interest in FNFLP of 19.97% and First National Financial Corporation [“FNFC” or the “predecessor”] indirectly holds the controlling interest of 80.03%. The Fund is an unincorporated, open-ended trust established under the laws of the Province of Ontario on April 19, 2006, pursuant to a Declaration of Trust. The Fund was established to acquire and hold, through a newly constituted wholly-owned trust, First National Financial Operating Trust [the “Trust”], investments in the outstanding limited partnership units of FNFLP. Pursuant to an underwriting agreement dated June 6, 2006 and an initial public offering dated June 15, 2006 and the exercise of an over-allotment option by the underwriters on July 11, 2006, in aggregate the Fund sold 11,800,000 units of the Fund [“Fund Units”, “Units” or “Unit”] at a price of \$10.00 per unit for proceeds totalling \$118,000. The proceeds of the offering, net of underwriters fees of \$6,360 and other offering costs of \$2,500, were used to partially fund the indirect acquisition [through the Trust] of FNFLP by the Fund through the issuance of Class A LP units by FNFLP.

Pursuant to the Limited Partnership Agreement between FNFLP, the Trust and FNFC dated June 15, 2006, First National Financial GP Corporation, as general partner, has full power and exclusive authority to employ all persons necessary for the conduct of the partnership, to enter into an agreement and to incur any obligation related to the affairs of the partnership and is entitled to full reimbursement of all costs and expenses incurred on behalf of the partnership. As general and administrative costs incurred by First National Financial GP Corporation are on behalf of the partnership, these costs have been reflected in the financial statements of FNFLP.

NOTE 2

Significant Accounting Policies

USE OF ESTIMATES

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including contingencies, at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results may differ from those estimates. Major areas requiring use of estimates by management are the securitization receivable and the fair values of financial assets and liabilities.

CHANGE IN FISCAL YEAR END

Pursuant to the acquisition, the initial public offering of the predecessor’s activities for the Company’s fiscal year end was changed from March 31 to December 31. Consequently, to provide readers additional information, comparative figures are disclosed for the nine-month period ended December 31, 2006 [audited] and the twelve-month period ended December 31, 2006 [unaudited].

CHANGES IN ACCOUNTING POLICIES

On January 1, 2007, the Company adopted three new accounting standards issued by The Canadian Institute of Chartered Accountants [“CICA”] – Section 1530 “Comprehensive Income”, Section 3855 “Financial Instruments – Recognition and Measurement” and Section 3865 “Hedges”. The adoption of these new accounting standards resulted in changes in the accounting for financial instruments and hedges as well as the recognition of certain transitional adjustments that have been recorded in opening retained earnings as required by the standards. The comparative financial statements have not been restated.

Section 3855 establishes standards for initially recognizing and subsequently measuring financial assets, financial liabilities and non-financial derivatives. It requires that financial assets and financial liabilities [including derivatives] and non-financial derivatives be recognized on the balance sheet when the Company becomes a party to the contractual provisions of the financial instrument or non-financial derivative contract. All financial instruments are required to be measured at fair value on initial recognition except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, either because they are acquired for resale over a short period of time or designated at management’s option as held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other liabilities.

Section 3855 permits an entity to designate any financial instrument as held-for-trading on initial recognition or adoption of this standard, even if that instrument would not otherwise satisfy the definition of held-for-trading set out in Section 3855. This is referred to as the fair

value option ["FVO"]. Financial instruments that are designated as held-for-trading must have reliable fair values since they are required to be presented at fair value. The Company has elected to apply the fair value option for certain financial assets and financial liabilities that do not otherwise meet the definition of held-for-trading set out in Section 3855.

The Company's financial assets on transition designated as held-for-trading under the fair value option include [i] cash collateral and short-term notes held by securitization trusts, [ii] securitization receivable, [iii] mortgages accumulated for sale, and [iv] securities owned and sold short.

Given the nature of the Company's recognized financial assets and liabilities, the Company believes that presentation of these instruments on a fair value basis provides for a more consistent view of the Company's financial position and results of operations at any point in time.

Financial assets classified as held-for-trading are measured at fair value with changes in their fair values recognized in income. Changes in fair value and realized gains or losses on financial instruments are recognized in realized and unrealized gains or losses on financial instruments in the Company's statements of income and retained

earnings. Fees earned by the Company including placement fees and servicing fees are recognized in income on an accrual basis.

Previously, the Company accounted for cash collateral and short-term notes held by securitization trusts, securitization receivable, mortgages accumulated for sale, mortgage and loan investments, and securities owned and sold short at amortized cost. Mortgage commitments and derivative instruments were previously not required to be recorded on the Company's balance sheets.

Section 3855 requires the recognition of derivatives on the balance sheets at fair value. Previously, the Company complied with the hedge accounting requirements of CICA Accounting Guideline 13 and maintained effective hedging relationships. Accordingly, unrealized gains and losses in effective hedging relationships were deferred in accounts receivable and sundry on the balance sheets until the ultimate securitization or sale of the hedged asset.

Under the transitional provisions of Section 3855, the Company has recorded an adjustment to increase opening retained earnings by \$2,680. The following table presents the transitional adjustments to financial instrument opening balances for the period commencing January 1, 2007, which are required to adopt the new standard:

	As at January 1, 2007		
	Carrying value	Transitional adjustment	Fair value
Assets			
Securitization receivable	\$ 77,949	\$ 4,372	\$ 82,321
Mortgages accumulated for sale	90,669	1,210	91,879
Accounts receivable and sundry ⁽¹⁾	16,846	(895)	15,951
Cash collateral and short-term notes held by securitization trusts	45,489	(1,802)	43,687
Liabilities			
Mortgage commitments	\$ -	\$ 205	\$ 205

(1) Realized gains or losses on hedge activities were previously recorded as part of accounts receivable and sundry under hedge accounting until mortgages were sold or securitized. On transition, these amounts were charged to retained earnings due to the Company's decision to cease hedge accounting.

The Company does not have any other comprehensive income components and, as such, comprehensive income is equal to net income. Accordingly, adopting Section 1530 has had no effect on the Company's financial statements. Similarly, as the Company has chosen not to designate any of its derivative instruments as hedges, adopting Section 3865 has had no immediate effect on the Company's financial statements.

For those financial assets and financial liabilities that have been designated as held-for-trading, the Company is not required to identify any embedded derivatives that might exist within these instruments. The Company conducted a search for embedded derivatives in all other contractual arrangements and did not identify any embedded features which required separate presentation from the related host contract.

REVENUE RECOGNITION

The Company earns revenue from placement, securitization and servicing activities related to its mortgage business. The majority of originated mortgages are funded either by placement of mortgages with institutional investors or the sale of mortgages to securitization conduits. The Company retains servicing rights on substantially all of the mortgages it originates, providing the Company with servicing fees.

Placement fees are earned by the Company for its origination and underwriting activities on a completed transaction basis when the mortgage is funded. Amounts collected or collectible in excess of the mortgage principal are recognized as placement fees.

Securitization revenue consists of gains on securitization and residual securitization income. The Company complies with CICA Accounting Guideline 12, "Transfers of Receivables". Accordingly, gains on securitization are recognized in income at such time as the Company transfers mortgages to securitization vehicles and surrenders control whereby the transferred assets have been isolated presumptively beyond the reach of the Company and its creditors, even in bankruptcy or other receivership. When the Company securitizes mortgages, it generally retains a residual interest, presented in the balance sheets as securitization receivable, and the rights and obligations associated with servicing the mortgages. The measurement of gains or losses recognized on the sale of mortgages depends in part on the previous carrying amount of the transferred mortgages, as allocated between the assets sold and the interests that are retained by the Company as the seller, based on the relative fair value of the assets and the retained interest at the date of transfer. To obtain fair values, quoted market prices are used where available. Since quoted prices are generally not available for retained interests, the Company estimates fair value based on the net present value of future expected cash flows, calculated using management's best estimates of key assumptions related to expected credit loss experience, prepayment rates and discount rates commensurate with the risks involved.

Residual securitization income represents the difference between the actual cash flows received on securitized mortgages and the assumed cash flows, recognized in income as received. Further, subsequent to

securitization, the fair value of retained interests is measured quarterly and compared to the securitization receivable at the balance sheet dates. Should the securitization receivable exceed the fair value of the retained interests determined by reference to underlying remaining expected cash flows, an impairment charge is included in residual securitization income to reduce the carrying value of the securitization receivable.

The Company services substantially all of the mortgages it originates, whether the mortgage is placed with institutional investors or transferred to a securitization vehicle. In addition, mortgages are serviced on behalf of third-party institutional investors and securitization structures. Servicing revenue is recognized in income on an accrual basis and is collected on a monthly basis from institutional investors. For securitized mortgages, the Company retains the rights and obligations to service mortgages and records a liability for future servicing and a reduction of gains on securitization at the time of transfer. Servicing income related to securitized mortgages is accreted to income over the life of the servicing obligation and included in residual securitization income. Interest income earned by the Company related to servicing activities is classified as mortgage servicing income.

In addition to the foregoing sources of revenue, the Company earns interest income which is recorded on an accrual basis from its interest bearing assets including securitization receivable, mortgage and loan investments and mortgages accumulated for sale. Prior to placement or transfer, funded mortgages are presented in the balance sheets as mortgages accumulated for sale which are typically held for a period of less than 180 days and are carried at cost.

BROKERAGE FEES

Brokerage fees incurred to originate mortgages are deferred and amortized to income over the term of the underlying mortgage. Upon placement or securitization of the related mortgages, brokerage fees are recorded as an expense.

CASH COLLATERAL AND SHORT-TERM NOTES

Commencing January 1, 2007, cash collateral and short-term notes held by securitization trusts are classified as held-for-trading under FVO and recorded at fair value. Previously, these assets were recorded at amortized cost.

MORTGAGE AND LOAN INVESTMENTS

Both prior and subsequent to January 1, 2007, mortgage and loan investments are carried at outstanding principal balances adjusted for unamortized premiums or discounts and are net of specific provisions for credit losses, if any.

Mortgage and loan investments are recognized as being impaired when the Company is no longer reasonably assured of the timely collection of the full amount of principal and interest. An allowance for loan losses is established only for mortgages and loans that are known to be uncollectible.

MORTGAGES ACCUMULATED FOR SALE

Mortgages accumulated for sale are mortgages funded on behalf of the Company's investors. These mortgages are held for terms usually not exceeding 90 days. Commencing January 1, 2007, these mortgages are classified as held-for-trading under FVO and recorded at fair value. Previously, these mortgages were recorded at amortized cost.

PURCHASED MORTGAGE SERVICING RIGHTS

The Company purchases the rights to service mortgages from third parties. Both prior and subsequent to January 1, 2007, purchased mortgage servicing rights are initially recorded at cost and charged to income over the life of the underlying mortgage servicing obligation. The fair value of such rights is determined on a periodic basis to assess the continued recoverability of the unamortized cost in relation to estimated future cash flows associated with the underlying serviced assets. Any loss arising from an excess of the unamortized cost over the fair value is immediately recorded as a charge to income.

BONDS SOLD SHORT AND BONDS PURCHASED UNDER RESALE AGREEMENTS

Bonds sold short consist of the short sale of a bond. Bonds purchased under resale agreements consist of the purchase of a bond with the commitment by the Company to resell the bond to the original seller at a specified price. The Company uses combinations of bonds sold short and bonds purchased under resale agreements to economically hedge its mortgage commitments and the portion of mortgages accumulated for sale it intends to securitize.

Commencing January 1, 2007, bonds sold short are classified as held-for-trading and recorded at fair value. Previously, bonds sold short were carried at the proceeds from sale amount plus accrued interest less accrued coupon. The accrued coupon on bonds sold short is recorded as interest expense. Bonds purchased under resale agreements are carried at cost plus accrued interest, which approximates market value. The difference between the cost of the purchase and the predetermined proceeds to be received on a resale agreement is recorded over the term of the hedged mortgages as an offset to interest expense. Transactions are recorded on a settlement date basis.

BONDS OWNED AND BONDS SOLD UNDER REPURCHASE AGREEMENTS

The Company purchases bonds and enters into bond repurchase agreements to close out economic hedging positions when mortgages are sold to special purpose entities or securitization vehicles.

These transactions are accounted for in a similar manner as the transactions described above for bonds sold short and bonds purchased under resale agreements.

INCOME TAXES

These financial statements are those of the partnership and do not reflect the assets, liabilities, revenues and expenses of its partners. FNFLP is a partnership carrying on business in Canada, and consequently, is not directly subject to federal or provincial income taxes. The income or loss for income tax purposes of the partnership is required to be allocated to FNFLP's partners. Accordingly, the tax provision (recovery) recorded in the comparative periods represents income taxes accrued on earnings while FNFC operated the Company's business from April 1, 2006 to June 14, 2006.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents consist of cash balances with banks and bank indebtedness.

DERIVATIVE INSTRUMENTS

Both prior and subsequent to January 1, 2007, derivative instruments are marked-to-market and recorded at fair value with the changes in fair value recognized into income as they occurred.

CAPITAL ASSETS

Capital assets are recorded at cost, less accumulated amortization, at the following annual rates and bases:

Computer equipment	30% declining balance
Office equipment	20% declining balance
Leasehold improvements	straight-line over the term of the lease
Computer software	30% declining balance except for computer license, which is straight-line over 10 years

VARIABLE INTEREST ENTITIES

The Company applies the guidance in CICA Accounting Guideline 15 ["AcG-15"], "Consolidation of Variable Interest Entities" when preparing its financial statements. AcG-15 provides a framework for identifying a variable interest entity ["VIE"] and requires a primary beneficiary to consolidate a VIE. A primary beneficiary is the enterprise that absorbs the majority of the VIE's expected losses or receives a majority of the VIE's residual returns, or both. The Company has interests in VIEs that are not consolidated because the Company is not considered the primary beneficiary.

NOTE 3

Securitization

The Company securitizes residential and commercial mortgage loans. In all of those securitizations, the Company retains servicing responsibilities and subordinate interests. In approximately 59% [2006 – 26%] of current-period securitizations, the Company securitized fixed-term mortgage loans through the NHA-MBS program and with institutional investors and received a fixed servicing fee for its servicing responsibilities. The remaining 41% [2006 – 74%] of those securitizations consisted of sales of fixed and floating rate mortgages to special purpose entities. In these cases, the Company does not receive an explicit servicing fee; instead, the Company receives subordinated interests consisting of rights to future cash flows arising after the investors in the special purpose entities have received the return for which they contracted, and provides credit enhancement to the special purpose entity in the form of cash collateral accounts and short-term notes. The investors and the special purpose entities have no recourse to the Company's other assets for failure of debtors to pay when due. The Company's retained interests are subject to credit, prepayment and interest rate risks on the transferred receivables.

During the year ended December 31, 2007, the Company securitized \$1,859,808 [nine-month period ended December 31, 2006 – \$2,152,161] of mortgage loans to special purpose entities, recognizing gains on securitization of \$44,416 [nine-month period ended December 31, 2006 – \$37,379]. The Company also recognized gains on securitization of \$9,101 [nine-month period ended December 31, 2006 – \$425], in addition to placement fees, from the placement with institutional investors of \$2,680,717 in mortgage loans during the year [nine-month period ended December 31, 2006 – \$762,534].

The liability for implicit servicing on securitization was \$16,124 as at December 31, 2007 [2006 – \$15,038]. In the absence of quoted market rates for servicing securitized assets, management has estimated, based on industry expertise, that the fair market value of this liability approximates its carrying value. Amortization of the servicing liability during the year ended December 31, 2007 amounted to \$5,962 [nine-month period ended December 31, 2006 – \$4,135] and is included in residual securitization income.

As part of its securitization activities, the Company provides cash collateral and invests in short-term notes for credit enhancement purposes as required by the rating agency. Credit exposure to securitized mortgages is limited to the securitization receivable, cash collateral and amounts invested in the notes. The securitization receivable is paid to the Company by the special purpose entity over the term of the mortgages, as monthly net spread income. The full amount of the cash collateral and the notes held by the securitization trusts, and accrued interest thereon, is also recorded as a receivable and the Company anticipates full recovery of these amounts. As at December 31, 2007, the cash collateral was \$42,202 [2006 – \$37,726] and the short-term notes were \$13,372 [2006 – \$7,763].

The key weighted average assumptions used in determining the securitization gains were as follows:

	2007	2006
Prepayment rate	12.9%	12.1%
Discount rate	6.4%	6.8%

There was no credit loss assumption used for insured mortgages as no loss is expected. For uninsured mortgages, the expected weighted average credit loss assumption used was 0.33% [2006 – 0.33%].

Cash flows received from securitization vehicles for the year ended December 31, 2007 and the nine-month period ended December 31, 2006 are as follows:

	2007	2006
Proceeds from new securitizations	\$ 5,445,614	\$ 2,887,222
Receipts on securitization receivable	45,023	24,591

The Company uses various assumptions to value the securitization receivable [excluding cash collateral and short-term notes held by the securitization trusts], which are set out below in the table, including the rate of unscheduled prepayments. Accordingly, the securitization receivable is subject to measurement uncertainty. The effect of variations

between actual experience and assumptions will be recorded in future statements of income and retained earnings. Key economic weighted average assumptions and the sensitivity of the current carrying value of residual cash flows to immediate 10% and 20% adverse changes in those assumptions are as follows:

2007	Commercial mortgage loans		Residential mortgage loans	
	Fixed rate	Adjustable	Fixed rate	Adjustable
Fair value of retained interests (FVO)	\$ 21,382	\$ 1,238	\$ 38,014	\$ 28,284
Average life (in months) ⁽¹⁾	56	11	44	48
Prepayment speed assumption (annual rate)	0.38%	29.8%	16.7%	16.5%
Impact on fair value of 10% adverse change	\$ 15	\$ 54	\$ 1,014	\$ 728
Impact on fair value of 20% adverse change	\$ 30	\$ 104	\$ 1,987	\$ 1,428
Residual cash flows discount rate (annual)	6.4%	6.6%	6.3%	6.4%
Impact on fair value of 10% adverse change	\$ 282	\$ 7	\$ 359	\$ 264
Impact on fair value of 20% adverse change	\$ 556	\$ 14	\$ 713	\$ 524
Expected credit losses	0.07%	0.09%	0.20%	0.05%
Impact on fair value of 10% adverse change	\$ 141	\$ 10	\$ 658	\$ 84
Impact on fair value of 20% adverse change	\$ 281	\$ 20	\$ 1,316	\$ 168

2006	Commercial mortgage loans		Residential mortgage loans	
	Fixed rate	Adjustable	Fixed rate	Adjustable
Fair value of retained interests (FVO)	\$ 18,628	\$ 2,550	\$ 23,110	\$ 33,661
Average life (in months) ⁽¹⁾	38	14	35	34
Prepayment speed assumption (annual rate)	0.9%	31.7%	12.6%	16.5%
Impact on fair value of 10% adverse change	\$ 14	\$ 82	\$ 644	\$ 896
Impact on fair value of 20% adverse change	\$ 27	\$ 161	\$ 1,266	\$ 1,759
Residual cash flows discount rate (annual)	6.0%	8.0%	7.0%	7.0%
Impact on fair value of 10% adverse change	\$ 282	\$ 19	\$ 275	\$ 360
Impact on fair value of 20% adverse change	\$ 556	\$ 37	\$ 545	\$ 713
Expected credit losses	0.07%	0.07%	0.24%	0.05%
Impact on fair value of 10% adverse change	\$ 107	\$ 13	\$ 366	\$ 111
Impact on fair value of 20% adverse change	\$ 214	\$ 26	\$ 732	\$ 221

(1) The weighted average life of prepayable assets in periods [for example, months or years] can be calculated by multiplying the principal collections expected in each future period by the number of periods until that future period, summing those products, and dividing the sum by the initial principal balance.

These sensitivities are hypothetical and should be used with caution. As the figures indicate, changes in carrying value based on a 10% or 20% variation in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in the table above, the effect of a variation

in a particular assumption on the fair value of the retained interest is calculated without changing any other assumption; in reality, changes in one factor may result in changes in another [for example, increases in market interest rates may result in lower prepayments and increased credit losses], which might magnify or counteract the sensitivities.

The Company estimates that the expected cash flows of the securitization receivable will be as follows:

2008	\$ 31,166
2009	24,404
2010	16,385
2011	10,135
2012 and thereafter	6,828
	\$ 88,918

Mortgages under administration are serviced as follows:

	2007	2006
Institutional investors	\$ 21,744,749	\$ 15,116,636
Securitization vehicles	6,007,966	5,309,532
CMBS conduits	5,361,700	3,933,313
	\$ 33,114,415	\$ 24,359,481

The Company's exposure to credit losses is limited to mortgages under administration totalling \$1,372,970 [2006 – \$1,026,876]. The Company incurred actual credit losses, net of recoveries, of \$1,128 during the year ended December 31, 2007 [nine-month period ended December 31, 2006 – \$185].

NOTE 4

Mortgage and Loan Investments

As at December 31, 2007, mortgage and loan investments consist primarily of commercial first and second mortgages held for various terms up to 19 years that are classified as loans and receivables. Due to the short-term, floating rate and bridging nature of most of

these mortgages, management believes that fair value approximates carrying value.

The contractual repricing in the table below is based on the earlier of contractual repricing or maturity dates.

	2007					2006
	Within 1 year	Over 1 to 3 years	Over 3 to 5 years	Over 5 years	Book value	Book value
Residential	\$ 4,670	\$ –	\$ –	\$ 14	\$ 4,684	\$ 3,431
Commercial	59,756	17,334	–	579	77,669	49,799
	\$ 64,426	\$ 17,334	\$ –	\$ 593	\$ 82,353	\$ 53,230

The Company has not experienced any credit losses or impairment on these items in the year ended December 31, 2007 or in the nine-month period ended December 31, 2006.

The maturity profile of mortgage and loan investments is as follows:

2008	\$ 64,426
2009	17,204
2010	–
2011	130
2012 and thereafter	593
	\$ 82,353

NOTE 5

Purchased Mortgage Servicing Rights

As at period end, the balance consists of the following components:

	2007			2006		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Third-party commercial mortgage servicing rights	\$ 3,614	\$ 1,708	\$ 1,906	\$ 3,614	\$ 1,445	\$ 2,169
CMBS primary and master servicing rights	8,705	857	7,848	5,492	394	5,098
	\$ 12,319	\$ 2,565	\$ 9,754	\$ 9,106	\$ 1,839	\$ 7,267

During the year ended December 31, 2007, the Company purchased servicing rights valued at \$3,213 [nine-month period ended December 31, 2006 – \$1,391]. Amortization charged to income for the year ended December 31, 2007 was \$726 [nine-month period ended December 31, 2006 – \$502].

During the year ended December 31, 2007 and the nine-month period ended December 31, 2006, management determined that the estimated fair market value of these assets at any time was not less than the Company's unamortized cost; accordingly, no write-downs were recorded during the periods.

NOTE 6

Capital Assets

Capital assets consist of the following:

	2007			2006		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Computer equipment	\$ 4,032	\$ 2,037	\$ 1,995	\$ 2,790	\$ 1,453	\$ 1,337
Office equipment	2,642	1,520	1,122	2,392	1,272	1,120
Leasehold improvements	2,012	916	1,096	1,293	721	572
Computer software	1,443	728	715	1,198	513	685
	\$ 10,129	\$ 5,201	\$ 4,928	\$ 7,673	\$ 3,959	\$ 3,714

NOTE 7

Bank Indebtedness

Bank indebtedness includes a one-year revolving line of credit of \$300,000 [2006 – \$200,000] maturing in June 2008, of which \$182,200 [2006 – \$163,900] was drawn at December 31, 2007 and against which the following have been pledged as collateral:

- [a] a general security agreement over all assets, other than real property, of the Company; and
- [b] a general assignment of all mortgages owned by the Company.

The revolving line of credit bears a variable rate of interest based on prime or bankers' acceptance rates.

NOTE 8

Swap Contracts

Swaps are over-the-counter contracts in which two counterparties exchange a series of cash flows based on agreed upon rates to a notional amount. The Company uses interest rate swaps to manage interest rate exposure relating to variability of interest earned on Commercial Mortgage Backed Securities ["CMBS"] payments held in trust as the master servicer. The swap agreements that the Company has entered into are interest rate swaps where two counterparties exchange a series of payments based on different interest rates applied to a notional amount in a single currency.

The following table presents the notional amounts and fair value of swap contracts as at December 31, 2007 and 2006 by remaining term to maturity:

2007	3 to 5 years	> 5 years	Total notional amount	Fair value
Interest rate swap contracts	\$ -	\$ 6,965	\$ 6,965	\$ 126

2006	3 to 5 years	> 5 years	Total notional amount	Fair value
Interest rate swap contracts	\$ -	\$ 5,665	\$ 5,665	\$ 81

NOTE 9

Income Taxes

Reconciliation of income taxes, for the period during which FNFLP was a taxable entity, consists of the following:

	Year ended December 31 2007	Nine-month period ended December 31 2006
Income before income taxes [while a taxable entity]	\$ -	\$ 10,578
Statutory income tax rate	-	35.64%
Income taxes at statutory rate	\$ -	\$ 3,770
Increase (decrease) resulting from		
Effect of future tax rate changes	\$ -	\$ (477)
Other non-deductible amounts for tax purposes	-	19
	\$ -	\$ 3,312

NOTE 10

Commitments and Guarantees

As at December 31, 2007, the Company has the following operating lease commitments for its office premises:

2008	\$ 3,075
2009	3,019
2010	3,037
2011	1,896
2012 and thereafter	1,203
	\$ 12,230

Outstanding commitments for future advances on mortgages with terms of one to 10 years amounted to \$1,801,339 as at December 31, 2007 [2006 – \$1,346,659]. The commitments generally remain open for a period of up to 90 days. These commitments have credit and

interest rate risk profiles similar to those mortgages which are currently under administration. Certain of these commitments will expire before being drawn down. Therefore, these amounts do not represent the Company's future cash requirements.

In the normal course of business, the Company enters into a variety of guarantees. Guarantees include contracts where the Company may be required to make payments to a party, based on changes in the value of an asset or liability that the party holds. In addition, contracts under which the Company may be required to make payments if a third party fails to perform under the terms of the contract [such as mortgage servicing contracts] are considered guarantees. The Company has determined that the estimated potential loss from these guarantees is insignificant.

NOTE 11

**Securities Owned and Sold Short
under Resale and Repurchase Agreements**

The Company's outstanding securities transactions under resale and repurchase agreements have a remaining term to maturity of less than one month.

NOTE 12

Statements of Cash Flows

The net change in non-cash working capital balances related to operations consists of the following:

	Year ended December 31 2007	Nine-month period ended December 31 2006
Accounts receivable and sundry	\$ (3,957)	\$ (6,531)
Mortgages accumulated for sale, net	12,820	(45,981)
Accounts payable and accrued liabilities	3,145	1,216
Income taxes payable	-	(12,482)
	\$ 12,008	\$ (63,778)

NOTE 13

Financial Instruments

RISK MANAGEMENT

The Company's risk management objective is to maintain interest rate spreads from the point that a mortgage commitment is issued to the sale of the mortgage to the related securitization structure. The Company uses bond forwards [consisting of bonds sold short and bonds purchased under resale agreements] to manage interest rate exposure between the time a mortgage rate is committed to borrowers and the time the mortgage is sold to the securitization trust and the underlying cost of funding is fixed. As interest rates change, the value of these interest rate financial instruments varies inversely with the value of the mortgage contract. As interest rates increase, a gain will be recorded on the economic hedge which will be offset by the loss on the sale of the mortgage to the securitization trust as the mortgage rate committed to the borrower is fixed at the point of commitment. For residential mortgages, only a portion of the commitments issued by the Company eventually fund. The Company must assign a probability of funding to each mortgage in the pipeline and estimate how that probability changes as mortgages move through the various stages of the pipeline. The amount that is actually economically hedged is the expected value of the mortgage funding within the future commitment period.

The maximum credit exposure of the financial assets are their carrying values as reflected on the balance sheets. The Company does not have significant concentration of credit within any particular geographic region or group of customers. The Company's accounts receivable, accounts payable and accrued liabilities, purchased mortgage servicing rights and servicing liability are not exposed to interest rate risk. The Company's floating rate interest bearing assets and liabilities such as mortgage and loan investments and bank indebtedness are subject to interest rate cash flow risk.

The Company's credit risk relates to the potential for financial loss resulting from the failure of a borrower to fully honour its financial or contractual obligations, such as the failure to repay principal and/or interest on the mortgage. The Company's approach to managing credit risk is based on the consistent application of a detailed set of credit policies and prudent arrears management. The Company's exposure is also mitigated by the short period over which a mortgage is held by the Company prior to securitization.

FAIR VALUE MEASUREMENT

The fair value of a financial instrument is the amount at which the instrument could be exchanged between arm's-length parties, in circumstances other than a forced or liquidation sale. The Company uses valuation techniques to estimate fair values, including reference to third-party valuation service providers using proprietary pricing models and internal valuation models such as discounted cash flow analysis. The valuation methods for each financial asset and financial liability are described below.

In estimating the fair value of financial assets and financial liabilities using valuation techniques or pricing models, certain assumptions are used including those that are not fully supported by observable market prices or rates. The amount of the change in fair value recognized by the Company in net income for the year ended December 31, 2007 that was estimated using a valuation technique based on assumptions that are not fully supported by observable market prices or rates was approximately \$21,529. Although the Company's management believes that the estimated fair values are appropriate at the balance sheet dates, those fair values may differ if other reasonably possible alternative assumptions are used.

VALUATION METHODS AND ASSUMPTIONS

The valuation methods and key assumptions used in determining fair values for the financial assets and financial liabilities are as follows:

[a] Cash collateral and short-term notes held by securitization trusts

The fair value is determined by discounting the expected cash flows related to these assets at estimated market interest rates. These rates are determined based on the amount of variability, mitigated by the assumptions inherent in the calculation of the securitization receivable.

[b] Securitization receivable

The fair value of securitization receivable is determined by internal valuation models consistent with industry practice using market data inputs, where possible. The fair value is determined by discounting the expected future cash flows related to the mortgages securitized at market interest rates. The expected future cash flows are estimated based on certain assumptions which are not supported by observable market data. Refer to Note 3 "Securitization" above for the key assumptions used and sensitivity analysis.

[c] Mortgages accumulated for sale

The fair value of these mortgages is determined by discounting projected cash flows using market industry pricing practices for discount rates at which similar loans made to borrowers with similar credit profiles and maturities would be discounted and, therefore, reflects changes in interest rates which have occurred since the mortgages were originated. Impaired mortgages are recorded at net realizable value.

[d] Mortgage commitments

The fair value reflects changes in interest rates which have occurred since the mortgage commitments were issued and is determined using standard industry pricing practices.

[e] Bonds sold short or purchased

The fair value of bonds sold short or purchased used by the Company to hedge its interest rate exposure is determined by independent third-party valuation providers using proprietary pricing models, incorporating prevailing market rates and prices on underlying instruments with similar maturities and characteristics.

[f] Other financial assets and liabilities

The fair value of mortgage and loan investments and bank indebtedness corresponds to the respective outstanding amounts due to their short-term maturity profiles.

[g] Impact of changes in fair values

The following table presents changes in the fair values of the Company's financial assets and financial liabilities for the year ended December 31, 2007, all of which have been designated as held-for-trading under the FVO except for the interest rate swaps which are required to be classified as held-for-trading:

	December 31 2007
Securitization receivable	\$ (15,669)
Mortgages accumulated for sale	(2,972)
Securities sold under repurchase agreements and sold short	(2,892)
Cash collateral and short-term notes held by securitization trusts	(3,011)
Interest rate swaps	-
Mortgage commitments	213
	\$ (24,331)

The fair value of financial instruments not listed above approximates their carrying value.

NOTE 14

Information about Major Customers

Placement fees, mortgage servicing income and gains on securitization revenue from three Canadian financial institutions represent approximately 46% of the Company's total revenue. During the year ended December 31, 2007, the Company placed 55% [nine-month period ended December 31, 2006 – 54%] of all mortgages it originated with the same three institutional investors.

NOTE 15

Earnings per Unit

Earnings per unit are calculated as follows:

	Year ended December 31 2007	Nine-month period ended December 31 2006
Net income available to unitholders	\$ 72,844	\$ 47,414
Number of unitholders [Class A and B]	59,086	59,086
Basic earnings per unit	1.23	0.80

NOTE 16

Earnings by Business Segment

The Company operates principally in two segments, Residential and Commercial. These segments are organized by mortgage type and contain revenues and expenses related to origination, underwriting, securitization and servicing activities. Expenses not allocated to segments relate to compensation paid to senior management. Identifiable assets are those used in the operations of the segments.

**FIRST NATIONAL FINANCIAL LP
NOTES TO FINANCIAL STATEMENTS**

	Year ended December 31, 2007		
	Residential	Commercial	Total
REVENUE			
Placement, securitization and servicing	\$ 185,271	\$ 32,369	\$ 217,640
Mortgage investment income	9,207	12,124	21,331
	194,478	44,493	238,971
EXPENSES			
Amortization	982	260	1,242
Interest	8,116	5,089	13,205
Other operating expenses	132,723	17,457	150,180
Corporate non-allocated expenses	–	–	1,500
	141,821	22,806	166,127
Income before income taxes	52,657	21,687	72,844
Identifiable assets	235,770	224,566	460,336
Capital expenditures	\$ 1,726	\$ 730	\$ 2,456

	Nine-month period ended December 31, 2006		
	Residential	Commercial	Total
REVENUE			
Placement, securitization and servicing	\$ 113,982	\$ 31,001	\$ 144,983
Mortgage investment income	5,058	6,386	11,444
	119,040	37,387	156,427
EXPENSES			
Amortization	619	184	803
Interest	2,948	4,074	7,022
Other operating expenses	86,400	10,559	96,959
Corporate non-allocated expenses	–	–	917
	89,967	14,817	105,701
Income before income taxes	29,073	22,570	50,726
Identifiable assets	188,001	340,115	528,116
Capital expenditures	\$ 898	\$ 138	\$ 1,036

NOTE 17

Future Accounting Changes

Capital disclosures

The CICA issued a new accounting standard, Section 1535, “Capital Disclosures”, which requires the disclosure of both qualitative and quantitative information that enables users of financial statements to evaluate the entity’s objectives, policies and processes for managing capital. This new standard will be effective for the Company effective January 1, 2008.

Financial instruments

The CICA issued two new accounting standards, Section 3862, “Financial Instruments – Disclosure” and Section 3863, “Financial

Instruments – Presentation”, which will be effective for the Company as of January 1, 2008. The adoption of these standards is not expected to have an impact on the operating results and financial position of the Company since these standards only deal with presentation and disclosures. These standards will apply to interim and annual financial statements.

NOTE 18

Comparative Financial Statements

The comparative financial statements have been reclassified from statements previously presented to conform to the presentation of the 2007 financial statements.

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EXCHANGE LISTING AND SYMBOL

TSX: FN.UN

ANNUAL MEETING

May 6, 2008, 10 a.m. ET
TSX Broadcast & Conference Centre
The Gallery
The Exchange Tower
130 King Street West
Toronto, Ontario



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